ORTH
OOM 1

UNIVERSITY
OF YORK
LIBRARY

G 6 BAS.

W. J. Davis

WITHDRAWN
FROM THE
UNIVERSITY
OF
LIBRARY

H. Howe

Nov. 1922.

Digitized by the Internet Archive
in 2026

https://archive.org/details/publicfinance0000cfba_d3t6_m1y5

PUBLIC FINANCE

MACMILLAN AND CO., LIMITED
LONDON . BOMBAY . CALCUTTA . MADRAS
MELBOURNE

THE MACMILLAN COMPANY
NEW YORK . BOSTON . CHICAGO
DALLAS . SAN FRANCISCO

THE MACMILLAN CO. OF CANADA, LTD.
TORONTO

PUBLIC FINANCE

BY

C. F. BASTABLE, M.A., LL.D.

PROFESSOR OF POLITICAL ECONOMY IN THE UNIVERSITY OF DUBLIN

'Finance is not mere arithmetic; finance is a great policy. Without sound finance no sound government is possible; without sound government no sound finance is possible.' WILSON.

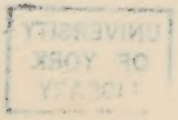
THIRD EDITION, REVISED AND ENLARGED

London

MACMILLAN AND CO., LIMITED

NEW YORK: THE MACMILLAN COMPANY

1917



COPYRIGHT

First Edition, 1892. *Second Edition*, 1895. *Third Edition*, 1903.
Reprinted 1907, 1908, 1909, *January and April* 1910, 1911, 1913, 1917.

C005 5207 00 05

UNIVERSITY
OF YORK
LIBRARY

PREFACE TO THE THIRD EDITION

In preparing this edition (which has been seriously delayed owing to pressure of other work) it has been my aim, while preserving the general character of the book, to give due place to the various recent contributions to financial theory and to the latest developments of fiscal policy in the leading countries of the world.

Thus, the discussions on the classification of public expenditure, the theory of minimum sacrifice as the principle for distribution of the public burdens, the controversies as to the division of taxation between countries with a common revenue system, as well as those on the true principles of local taxation, have been noticed. So have the latest theories on the ever-recurring question of incidence. But though we must gladly recognise the increased interest that the revival of economic inquiry has attracted to the more abstract side of financial theory, it is yet essential to remember that the new matter is small in proportion to the body of pre-existing doctrine. There has been no fundamental change, but only that expansion which is characteristic of all scientific study. Hence the space allotted to the topics mentioned above has been rigidly restricted and their relation to the general system made as obvious as possible.

The movements of financial policy have been similarly treated. The new French inheritance taxes, the reform of direct taxation in Austria, the temporary duties in the United States for the purposes of the Spanish war, as well as the improvements which the same event has produced in Spanish finance, all these have found their natural place in the descriptive and historical notices of the several taxes. The most remarkable, and to English readers the most serious, of these practical developments has been the alteration in the direction of English financial policy brought about by the occasion of the South African war, but really due to a deeper cause, viz. the desire to secure what is described as a broader basis for taxation. Under the influence of this idea, urged by an influential section of public opinion and obtaining additional support from the protectionist party, the customs tariff has been first extended in the form of a revenue duty on sugar, accompanied by a return to the primitive policy of an export duty on coal, and followed by a trivial, but so far protective, tax on corn. These measures, when considered, as they should be, in connexion with the legislation on matters of economic policy of the past seven years, indicate a disposition on the part of the predominant political party to depart from the financial principles which have prevailed since 1860. This attempt, whatever be its fate, is one of great interest to the scientific student of finance. The success that has attended the financial measures of Peel and Gladstone, and the remarkable contrast between the position of Great Britain and that of other European states in respect to economic and financial conditions, suggest the belief that experiments such as the coal and corn duties are undesirable, while any great extension of the policy would be hazardous in the extreme.

But whether the general basis of the established English revenue system be retained or abandoned, it is beyond doubt that the growth of expenditure presents a grave

problem for the future. In spite of warnings from responsible members of both parties, there has been an automatic increase in outlay that necessarily involves a heavier tax burden. No readjustment of taxes can give an escape from this result. The income of the citizen may, indeed, be attached directly, or by a series of indirect charges. The adoption of the latter method will not, however, reduce the amount of pressure; in some respects it will decidedly aggravate it. Prudent selection of the forms of taxation may afford some relief, just as mistaken choice will add to the loss, but speaking broadly, Ricardo's emphatic statement holds good that "the great evil of taxation is to be found not so much in any selection of its objects as in the general amount of its effects taken collectively" (*Works*, p. 88). It may be reasonably held that the future progress of Great Britain and of the British Empire will depend largely on the course that financial policy takes.

Of almost equal importance is the problem—or series of problems—presented by local finance. Expenditure and debt are both on the advance in the municipalities of the United Kingdom, and, if unchecked, will compel the adoption of new kinds of taxation or an appropriation of fresh fields of industry for municipal enterprise. In this case also there is need for that care and prudence which takes remote as well as immediate results into account and makes adequate allowance for risk. A full exhibition of national and local expenditure along with the corresponding debt figures does not produce a reassuring effect, especially when we consider the new claims that are from time to time arising. Firm financial administration and a wise economy of the public resources seem to be urgently needed in order to preserve the high reputation that British policy has won for itself. The great difficulty that has to be overcome is not the weakness of ministers, but negligence and want of knowledge on the part of the mass of the

community. A better informed and more reasonable public opinion is an essential pre-requisite of financial as of all other reforms in the modern State.

C. F. BASTABLE.

Trinity College, Dublin
January 31st, 1903

FROM PREFACE TO SECOND EDITION

THOUGH no substantial change has been made in any point of doctrine or arrangement, the facts and figures have been thoroughly revised and brought up to date. Many important financial measures have been adopted during the last three years, and have required some notice. It is indeed, neither possible nor desirable, in a work primarily devoted to the statement of principles, to include all the transitory phases of legislative action; but the alterations recently carried out in the United Kingdom and Prussia are instructive examples of the direction of modern financial policy. . . . They have accordingly been described in their proper connection, and in consequence of the scientific and practical interest of the subject a chapter dealing with "death duties" has been added. A more theoretical addition is the new chapter on the "maxims of taxation," which replaces the historical appendix in the first edition.

It is satisfactory to note that there has been a distinct revival of interest in respect to financial questions, as shown by the recent contributions to the literature of the subject, the more important of which have been duly referred to. It may without rashness be conjectured that the chief points of controversy in the immediate future will refer to local rather than to imperial finance, a statement which is applicable to France and the United States as well as our own

country. The due adjustment of the two complementary systems of central and local finance will call for the efforts of skilled statesmanship guided by sound principles.

The criticisms and suggestions made by numerous reviewers and correspondents have been carefully considered, and, I hope, properly used. Among published criticisms I feel specially indebted to those by Professors Cohn, Seligman, and Farnam. Of those made privately I would particularly mention the valuable remarks by Professor Foxwell, Mr. E. Cannan, and Mr. C. S. Devas.

C. F. BASTABLE.

FROM PREFACE TO FIRST EDITION

THE subject of Public Finance, as distinct from that of Political Economy, has not of late years attracted much attention in Great Britain. The very excellence of English financial institutions and management has contributed to this result by making the need of theoretic study as a basis for practical reforms less pressing. Though our financial literature is not quite so poor as some critics imagine, it must be allowed to be deficient in works dealing with the subject as a whole. Since the well-known book of McCulloch—first published in 1845 and now out of print—there has been no manual available for the student.

Such a want is specially felt in the work of teaching. A lecturer who desires to deal with financial questions has no text-book—like those at the service of his French, German, and Italian colleagues—to use as the groundwork of his instruction, and is therefore compelled to make constant reference to foreign treatises not readily accessible to, or easily read by, his class.

In the present work I have sought to temporarily supply this need by going over the whole field of Public Finance and presenting the results in a systematic form, so that a student may at least obtain a general knowledge of the leading facts and present position of this branch of

political science. The selection of topics and the space assigned to each have been determined under the influence of this guiding idea.

In dealing with financial statistics—which have been kept within the narrowest possible limits—I have in most cases rounded the figures in order to fasten attention on the really important facts expressed by them. For the same reason in the conversion of foreign money into English I have been satisfied with the approximate equation of £1 = $5 = 25 francs or lire = 20 marks. The fluctuations of the rupee, the Austrian florin, and the rouble have generally made their conversion undesirable, but I have sometimes taken them at their exchange value. Finally, I should explain that the references are, unless where otherwise stated, to the volume and page of the particular author.

C. F. BASTABLE.

CONTENTS

INTRODUCTION

CHAPTER I

§§ 1, 2. Nature and scope of Public Finance. § 3. Its relation to economics. § 4. To history and statistics. § 5. Its appropriate method; must combine induction and deduction. § 6. Outline of present work . . . . . pp. 1–15

CHAPTER II

§ 1. Need for studying the development of financial theory. § 2. Reasons for its absence in ancient times. § 3. And in the Middle Ages. City finance. § 4. Its commencement. Bodin. § 5. The German Cameralists. Vauban, Montesquieu, Hume. § 6. The Physiocrats: their influence. § 7. Adam Smith's *Wealth of Nations*; its position and merits. § 8. His English successors. Modern French writers. § 9. The German followers of Adam Smith. Later financial theories in Germany. § 10. Financial writers in Italy. § 11. Other countries—Holland, Spain, &c. § 12. Recent English works on Finance. § 13. Financial theories in America . . pp. 16–37

BOOK I

PUBLIC EXPENDITURE

CHAPTER I

STATE ECONOMY. GENERAL CONSIDERATIONS

§ 1. Expenditure necessary in all economies. § 2. Special features of public economy. § 3. Classification of public wants by J. S. Mill

and Roscher. § 4. Theories of State functions. Paternal government. *Laissez faire.* Adam Smith's statement. J. S. Mill. Modern position. § 5. The development of State functions in the several social stages. § 6. Permanence of certain wants. § 7. Commodities and services both required . . . . . pp. 41–57

CHAPTER II

THE COST OF DEFENCE

§ 1. Increase of expenditure for this object. § 2. Partly in preparation, partly for actual warfare. §§ 3, 4. Development of the military organisation. Its dependence on economic conditions. § 5. Volunteer service. § 6. Cost of navies. § 7. Growing cost of war *matériel*, possible alleviations. § 8. Cost of warfare. § 9. Summary. Note . . . . . pp. 58–73

CHAPTER III

JUSTICE AND SECURITY

§ 1. Importance of the function, its extent. § 2. Its development. The fee theory. §§ 3, 4. Compulsory and voluntary services. § 5. Police expenditure. § 6. The prison system . . . . . pp. 74–81

CHAPTER IV

ADMINISTRATIVE SUPERVISION. POOR-RELIEF

§ 1. Decay of state regulation; its revival. § 2. Reasons for this new growth. § 3. Tests of its expediency. § 4 The problem of poor-relief. Conflicting arguments. § 5. Practical result. § 6. Other modes of assistance . . . . . pp. 82–91

CHAPTER V

EDUCATION. RELIGION

§ 1. The State in relation to education. § 2. Primary education. § 3. Secondary education. § 4. University education. 5. Technical education. § 6. Other means of culture. § 7. Voluntary aid. § 8. Religious endowments . . . . . pp. 92–100

CHAPTER VI

EXPENDITURE ON INDUSTRY AND COMMERCE. CONSTITUTIONAL AND DIPLOMATIC EXPENDITURE

§ 1. All expenditure partly for economic ends. § 2. Action of the State to encourage industry generally. § 3. Assistance to special branches of industry and commerce. § 4. Over-expenditure for this purpose rare. §§ 5, 6. Maintenance of the Government. § 7. Cost of public debt and revenue collection . . . . . pp. 101–109

CHAPTER VII

CENTRAL AND LOCAL EXPENDITURE

§ 1. Real unity of general and local government. § 2. Differences in local government the result of historical conditions. § 3. But yet conform to general principles. § 4. Opposing tendencies. § 5. Greater complexity of local government in modern times. Its causes. § 6. Division of financial duties between the State and local bodies. § 7. Application to the several heads of expenditure. § 8. Some special cases. § 9. Central control expedient. Note.—Confederate and Colonial finance . . . . . pp. 110–129

CHAPTER VIII

SOME GENERAL QUESTIONS OF EXPENDITURE

§ 1. Ordinary and extraordinary expenditure. Various uses of these terms. § 2. Productive and unproductive expenditure. §§ 3, 4. Relation of public to national revenue. Proper limit of the former. § 5. Growth of expenditure in modern times. Its causes. § 6. Influence of public expenditure on the national economy. Appendix. On the classification and guiding maxims of public expenditure pp. 130–149

BOOK II

PUBLIC REVENUE

THE ECONOMIC OR QUASI-PRIVATE RECEIPTS

CHAPTER I

THE FORMS AND CLASSIFICATION OF PUBLIC REVENUES

§ 1. Expenditure and revenue correlative. § 2. Complexity of the forms of revenue. Attempted classifications. § 3. Criticisms. § 4. The

true arrangement. § 5. Divisions of the economic revenue. Note on classification . . . . . pp. 153–168

CHAPTER II

THE STATE DOMAIN. LANDS AND FORESTS

§ 1. The origin of the domain. §§ 2, 3. Its present position in the several countries of the world. § 4. Land nationalisation. § 5. Arguments for and against the retention of public lands. § 6. Methods of management. § 7. Increase of public lands undesirable. § 8. Exception in the case of forests. § 9. The actual position of public forests. § 10. Division of management between central and local governments . . . . . pp. 169–190

CHAPTER III

THE INDUSTRIAL DOMAIN

§ 1. Contrast between agricultural and industrial domain. § 2. State mines. § 3. State manufacture of fine products and for its own use. § 4. Monopoly of manufacture for taxation. §§ 5, 6. Municipal industries. Water-supply, lighting, drainage. § 7. The Post Office, its history and present position. § 8. It is a combination of several distinct industries. § 9. Its financial bearings. § 10. State telegraphs. § 11. Roads and canals. § 12. Treatment of railways. § 13. French railway policy. § 14. German state railways. § 15. Other European railways. § 16. Railway policy of non-European countries. § 17. Objections to the system of state railways. § 18. Municipal tramways. § 19. The management of state railways. § 20. Treatment of state employees. § 21. Financial importance of the industrial domain . . . . . pp. 191–231

CHAPTER IV

THE STATE AS CAPITALIST. ADMINISTRATIVE REVENUE

§ 1. Decline of state trading. § 2. State banks. § 3. Public lotteries. § 4. The State as lender. § 5. Fixed charges on land. § 6. Dues. § 7. The fee system. § 8. Juridical fees. § 9. Administrative and miscellaneous fees. § 10. Heterogeneous character of the revenue from fees . . . . . pp. 232–245

CHAPTER V

STATE PROPERTY. GENERAL CONSIDERATIONS ON QUASI-PRIVATE REVENUE

§ 1. Growth of public property that does not yield revenue. § 2. Contrast between economic and tax receipts. § 3. Division of the former between central and local government. § 4. Difficulty of laying down general rules on the subject. § 5. Proportion of economic receipts to total revenue. Distribution between net and gross revenue. § 6. Proportion in England, Germany, and India. § 7. Inferior position of economic revenue . . . . . pp. 246–257

BOOK III

PUBLIC REVENUE (*continued*)

THE PRINCIPLES OF TAXATION

CHAPTER I

DEFINITION AND CLASSIFICATION OF TAXATION

§ 1. Prominence of taxation in finance. § 2. Need of definitions. § 3. Definition of taxation. §§ 4, 5. Other definitions; errors in this connexion. § 6. Etymological meaning of terms. § 7. 'Subject' and 'source' of taxation. § 8. Use of terms, 'direct' and 'indirect,' 'real' and 'personal,' 'rated' and 'apportioned.' § 9. Economic classification of taxes. § 10. Empirical classification. § 11. Points of connexion between the two systems. Suggested grouping. § 12. Recapitulation . . . . . pp. 261–280

CHAPTER II

THE GENERAL FEATURES OF TAXATION

§ 1. Study of the broader features of taxation essential. § 2. Taxation means a deduction of wealth and therefore is an evil; fallacies on this head. § 3. Taxation hardly ever increases production. § 4. It is often uneconomical. § 5. Income the normal source of taxation, but wealth must also contribute. § 6. Theory of net produce; Physiocratic view. § 7. Later German theories. § 8. Importance of the preceding discussions. Case of Ireland . . . . . pp. 281–295

CHAPTER III

THE DISTRIBUTION OF TAXATION

§ 1. Distribution an ethical question, but involves economic considerations. § 2. The theory of payment for state service; its error. § 3. Equal payment by all. Ability as a measure of taxation. § 4. Sacrifice as the measure. Equal sacrifice and least sacrifice. § 5. Proportional taxation advocated by the classical economists. § 6. Progressive taxation; reasons for its popularity. § 7. Objections to its use. § 8. Arguments in its support. § 9. The results of experience. § 10. Degressive taxation. § 11. Exemption of the minimum of subsistence. § 12. Treatment of (*a*) temporary incomes, (*b*) savings. § 13. Summary of preceding sections. § 14. Taxation of speculation and unearned increment. § 15. Distribution of taxation between countries united under a common government. § 16. International double taxation. § 17. Politico-social view. § 18. Theory that distribution is not concerned with justice . . . . . pp. 296–337

CHAPTER IV

THE TAX SYSTEM. ITS FORMS

§ 1. Single and multiple taxation. § 2. Proposals of Vauban and Decker [?]. § 3. The *Impôt unique* of the Physiocrats. § 4. Objections to the single tax. § 5. Evils of multiple taxation. § 6. Variety in taxation desirable. § 7. Meanings of direct and indirect taxation. § 8. Merits and defects of direct taxation. § 9. Those of indirect taxation. § 10. Other taxes. § 11. Combination of the three classes desirable. § 12. And likely to continue . . pp. 338–359

CHAPTER V

THE SHIFTING AND INCIDENCE OF TAXATION

§ 1 Importance of the question. § 2. Development of the economic theory of incidence; the Physiocrats, Adam Smith, Ricardo, J. S. Mill. § 3. Criticism of this theory. § 4. The diffusion theory of taxation; its supporters; its defects. § 5. The incidence of taxes on commodities. § 6. The incidence of taxes on rent and the shifting of taxation to rent. § 7. Taxes on capital and employer's gain; their varied incidence. § 8. Taxes on wages not always shifted. § 9. Complicated nature of shifting . . . . . pp. 360–388

CHAPTER VI

THE PRINCIPLES OF LOCAL TAXATION

§ 1. Reasons for separating local from general taxation. § 2. The history of local institutions helps to determine their revenue. § 3. Taxes which should belong to the central government. § 4. Those suitable for local governments. § 5. Just distribution in local taxation. § 6. Special assessments. § 7. Relations between general and local finance. § 8. The amount of liberty to be granted to local bodies . . . . . pp. 389–410

CHAPTER VII

THE CANONS OF TAXATION

§ 1. Advantage of general rules. § 2. Their slow development; earlier attempts. § 3. Adam Smith's maxims; criticisms thereon; their true position. § 4. Additional canons. Sismondi's four rules; their character. Garnier, Held, Wagner. § 5. Suggested canons, (*a*) productiveness, (*b*) economy, (*c*) just distribution, (*d*) elasticity, (*e*) certainty, (*f*) convenience. § 6. Their character and general agreement . . . . . pp. 411–421

BOOK IV

PUBLIC REVENUE (*concluded*)

THE SEVERAL KINDS OF TAXES

CHAPTER I

TAXES ON LAND

§ 1. Antiquity of land taxes. § 2. Their development. § 3. *Cadastral* surveys. § 4. English taxation of land. § 5. The *Impôt foncier* in France. § 6. Land taxes in Italy, Spain, Portugal, Belgium, and Greece. § 7. Land taxation in Germany, Austria, and the United States. § 8. General features of land taxation. § 9. Its incidence. The Amortisation theory . . . . . pp. 425–442

CHAPTER II

TAXES ON CAPITAL AND BUSINESS

§ 1. Development of taxes on buildings. § 2. In England. § 3. House and building taxes in other countries. § 4. Further considerations. § 5. Incidence of taxes on buildings. § 6. Taxation of floating capital. § 7. Profits more readily dealt with. § 8 Taxation of profits in England. § 9. The *Patente* in France. § 10. Taxation of profits in Italy, Germany, and Austria. § 11. The corporation tax in the United States. § 12. Characteristics of Continental taxation of profits. § 13. The incidence of taxes on business profits . . . . . pp. 443–464

CHAPTER III

PERSONAL AND WAGES TAXES

§ 1. Origin of poll taxes. § 2. English and Continental examples. § 3. Decline of poll and wages taxes; their unfairness . . . pp. 465–468

CHAPTER IV

TAXES ON PROPERTY AND INCOME

§ 1. The older property tax; its defects. § 2. Its survival in Switzerland; peculiarities of the system. § 3. The property tax in the United States; its defects. § 4. New property taxes in Prussia and Holland. § 5. Beginnings of the income-tax. § 6. The English income-tax. § 7. The income-tax in Italy. § 8. In the German States, Austria, and Switzerland. § 9. Proposed income-taxes in the United States and France. § 10. General considerations on the income-tax. § 11. Its incidence . . . . . pp. 469–494

CHAPTER V

TAXES ON CONSUMPTION: THEIR CLASSIFICATION: DIRECT CONSUMPTION TAXES

§ 1. Secondary or consumption taxes. § 2. Their classification. § 3. Origin and decline of direct taxes on consumption. § 4. English taxes of this class. § 5. These taxes in other countries. § 6. Best reserved for local purposes . . . . . pp. 495-503

CHAPTER VI

INTERNAL TAXES ON COMMODITIES

§ 1. Importance of excise taxes; their development. §§ 2, 3. Problems of excise taxation. § 4. It must be suited to the particular country. § 5. History and present position of the British Excise. § 6. History of the French indirect taxes. § 7. The existing French system: its principal features, its defects. § 8. Italian taxation of commodities. § 9. History of the German Excises; small return under the present system. § 10. Internal taxation in Austria and Russia. § 11. In the United States and India. § 12. General features of modern internal taxation. § 13. The history of *Octrois*. § 14. Their present use. § 15. Criticism of the *Octroi* system. § 16. Incidence of excise duties . . . . . pp. 504–550

CHAPTER VII

CUSTOMS DUTIES

§ 1. The early forms of customs taxation. Its gradual development. § 2. Customs to be considered in connexion with the Excise. § 3. The English customs system, its history and chief features. § 4. French customs duties; their financial defects. § 5. Customs duties in Italy, Germany, and other countries. § 6. Intrusion of political motives into the customs system. Prominence of import duties. § 7. The incidence of customs duties. Complicated nature of the problem . . . . . pp. 551–573

CHAPTER VIII

TAXES ON COMMUNICATIONS AND ACTS

§ 1. Different elements that contributed to the establishment of taxes on circulation. § 2. Taxes on communication and transport. § 3. Stamps as a form of taxation. § 4. Taxation on acts and transactions. § 5. Stamp and registration duties in England, France, Italy, and Germany. § 6. Incidence of taxes on acts . . . pp. 574–589

CHAPTER IX

TAXES ON SUCCESSIONS

§ 1. Peculiar features of taxes on successions; their origin. § 2. Defects of succession taxes. § 3. Place of these taxes in a fiscal system. § 4. Graduation and progression. § 5. History of the English

death duties. § 6. Changes by the Finance Act, 1894; its leading provisions. § 7. Productiveness of the death duties. § 8. Inheritance taxes in France. § 9. In Italy, Germany, Switzerland, and Australasia. § 10. State and federal inheritance taxes in the United States. § 11. The incidence of taxes on successions . . . . pp. 590–608

BOOK V

THE RELATION OF EXPENDITURE AND RECEIPTS

CHAPTER I

INTRODUCTORY. STATE TREASURES

§ 1. Impossibility of keeping complete equality between expenditure and receipts. § 2. Ancient and mediæval state treasures. § 3. Reasons for state hoarding. The present German reserve. Objections to the system of keeping a reserve. § 4. Public debts more important at present . . . . . pp. 611–618

CHAPTER II

PUBLIC INDEBTEDNESS. ITS MODERN DEVELOPMENT

§ 1. No state borrowing in classical times. § 2. Mediæval state borrowing. § 3. Causes of modern public debts. § 4. Their rapid growth. § 5. Summary . . . . . pp. 619–628

CHAPTER III

THE HISTORY OF THE ENGLISH DEBT

§ 1. Commencement of the debt at the Revolution; its early progress (1692–1740). § 2. Chief features in that period. § 3. The second period (1740–1792). § 4. The English debt during the French war (1793–1815). § 5. (1815–55). History of the debt. The Crimean War. § 6. Reduction of debt by redemption and conversion, 1856–99. § 7. Loans for the South African War. § 8. The continued existence of the debt due to war and to weak financial policy . . . . . pp. 629–642

CHAPTER IV

HISTORY OF THE FRENCH DÈBT. INDEBTEDNESS IN OTHER COUNTRIES

§ 1. Borrowing under the *Ancien Régime*. § 2. The formation of the present debt (1793–1870). § 3. The Franco-German war. The actual position. § 4. Public debts in Italy and Germany. § 5.

The history and present position of the United States debt. § 6. Debts of Austria, Russia, and the English colonies . . . . pp. 643–657

CHAPTER V

THE THEORY OF PUBLIC CREDIT AND PUBLIC DEBTS

§ 1 Public credit is one species of credit in general, and governed by the principles applicable to all credit. § 2. Peculiar features of public credit. § 3. Early theories as to advantages of public debts. § 4. The views of Montesquieu, Hume, and Adam Smith. Truth and error in their position. § 5. The theory of Chalmers and J. S. Mill. § 6. German doctrines: C. Dietzel's theory of reproductive borrowing. § 7. Criticism of Chalmers. § 8. Of the theory of reproductive borrowing. § 9. The real effect of borrowing. Taxation and borrowing contrasted. § 10. Borrowing sometimes desirable. General rules. § 11. Foreign loans. § 12. Modes of estimating the pressure of public debt . . . . . pp. 658–684

CHAPTER VI

THE FORMS OF PUBLIC DEBTS

§ 1. Forced, patriotic, and business loans. § 2. Temporary and perpetual debts. Advantage of the latter. § 3. Variety desirable. § 4. Methods of contracting loans. § 5. Loans should not be contracted under *par*. § 6. Floating debt: its treatment. § 7. Inconvertible paper . . . . . pp. 685–697

CHAPTER VII

THE REDEMPTION AND CONVERSION OF DEBT

§ 1. Redemption of debt desirable. § 2. Conditions to be considered in this process. § 3. All payment must be out of surplus revenue. The Sinking Fund: its error. § 4. Necessity of debt reduction. § 5. Conversion as a mode of relief. § 6. Redemption by a single contribution from property. § 7. Automatic reduction of debt. § 8. Is there any distinction between home and foreign loans in respect to redemption? . . . . . pp. 698–711

CHAPTER VIII

LOCAL INDEBTEDNESS

§ 1. Danger in the increase of local debt. § 2. Instances of increase in England and abroad. § 3. Causes of this increase, § 4. Local borrowing often justifiable. § 5. Forms of local loans. § 6. Repayment also necessary in their case. § 7. Provincial and county borrowing. § 8. Necessity for central control over local borrowing pp. 712–722

BOOK VI

FINANCIAL ADMINISTRATION AND CONTROL

CHAPTER I

INTRODUCTORY. HISTORICAL DEVELOPMENT

§ 1. Administration and control a necessary part of financial science. § 2. Gradual development of financial regulation. Classical and mediæval periods. § 3. Regulation under absolute monarchy. § 4. Constitutional system of English origin. § 5. Its extension to other countries. § 6. Modern financial systems admit of general treatment . . . . . pp. 725–733

CHAPTER II

THE BUDGET: ITS PREPARATION. THE COLLECTION OF REVENUE

§ 1. Meaning of the term 'Budget.' § 2. Preliminary estimates necessary. § 3. Period, form, and matter of the Budget. Should it be 'gross' or 'net'? § 4. Unity of the Budget. Should it deal with cash or transactions? Modes of estimating income and outlay. § 5. The collection of taxation. Farming of taxes. Apportionment. Direct state levy. Rules respecting it. § 6. Dealing with the funds received . . . . . pp. 734–745

CHAPTER III

THE VOTE OF THE BUDGET. ITS CONTROL AND AUDIT

§ 1. Summary of budgetary rules. § 2. Method of examining the Budget. Right of proposing expenditure. § 3. Relative powers of the two chambers. Specialisation of votes. § 4. Difficulty of adjusting income to outlay. Supplemental votes. Fixed expenditure and taxation. § 5. Comparison of English and French methods. § 6. Checks over issues. Their development in England, France, and Italy. § 7. Methods of audit. The English appropriation audit. The United States system. French *Cour des Comptes*. Other countries. § 8. Importance of sound public opinion . . . . . pp. 746–761

CHAPTER IV

ADMINISTRATION AND CONTROL IN LOCAL FINANCE

§ 1. Surbordinate position of local bodies. § 2. Historical development of control. § 3. Preparation of local budgets. § 4. Voting of local budgets. § 5. Necessity for external audit and control. § 6. Political control. Conclusion . . . . . pp. 762–769

INTRODUCTION

CHAPTER I

§ 1. In any society that has passed beyond the lowest stage of social development, some form of governmental organisation is found to be an essential feature. The various activities or functions of this controlling body furnish the material for what are known as the 'Political Sciences' (*Staatswissenschaften*). Every governing body or 'State' requires for the due discharge of its functions repeated supplies of commodities and personal services, which it has to apply to the accomplishment of whatever ends it may regard as desirable. The processes involved in obtaining and using these supplies naturally vary much in the several stages of social advance: they are comparatively simple and direct in a primitive community, while in a modern industrial society they present a high degree of complication, and are carried out by elaborate regulations. For all States, however—whether rude or highly developed—some provisions of the kind are necessary, and therefore the supply and application of state resources constitute the subject-matter of a study which is best entitled in English, Public Finance.[1]

[1] For the various meanings of the term 'Finance,' see Roscher, § 1, also Garnier, 1–3. The original idea is that of paying a fine (*finare*). Unfortunately, in England the word has been used with a wider meaning, as including all monetary and even industrial facts. Thus we have Jevons's *Investigations in Currency and Finance*, Mr. Patterson's *Science of Finance*, and Sir R. Giffen's *Essays in Finance*, all dealing mainly with those wider questions. An English

The importance of the subject hardly requires much insistence. The collection of funds for state purposes and the use of the resources so obtained are such vital parts of the political organisation, that they are almost certain to receive attention from all who are interested in political and social inquiries. But, if demanded, abundant evidence is at hand. The citizen of any civilised country need only reflect for a few minutes in order to satisfy himself of the number and importance of the actions of the state on its financial side. His letters are carried by a state agency which claims a monopoly, and in some instances realises a large profit for the general revenue. The commodities that supply his table are in many cases taxed to create a fund for the payment of public services. Either his income or property or some of their elements is sure to be subjected to a charge of greater or less amount, and several of the most ordinary avocations are only open to him on obtaining a costly licence for permission to engage in them. Nor do the claims of the State cease here. In addition to the central body, the local authorities have to be considered. If the person of our supposition be the inhabitant of a town, his house may be lighted by public agency, while it is highly probable that for one of the first necessaries of life—water—he is dependent on his municipality. There is little need for further working out of details. The way in which the purely financial agencies of the State—and still more those which have some connexion with finance—affect the members of the society in their everyday existence, is being ever illustrated afresh by the ordinary course of social life.

writer is therefore compelled, in order to avoid misapprehension, to limit the word as in the text, when he is treating of what the Germans can without inconvenience call *Finanzwissenschaft*, or the French *Science des Finances*. In French there is a convenient distinction between the singular and plural, the former being used in the general sense, as in *La haute finance*, while the latter is reserved for 'public finance.' Prof. Adams has recently employed the term 'Science of Finance' to describe 'an investigation of public expenditures and public revenues.' Profs. Plehn and Daniels have followed in the titles of their manuals the example of this work.

The importance of a subject is of itself a strong plea for its scientific study, but in the present case more special arguments may be urged. There is in finance, as in all matters depending in some degree on human will, the possibility of choosing between different courses, some of which are likely to prove better than others; and for the formation of a correct judgment as to the relative merits of the lines of action open to the State, careful examination of the conditions affecting the phenomena is indispensable. Such examination is, however, only possible by scientific study, or rather it is that study. More particularly is this true at present in consequence of the great expansion of the functions of the State, which is partly due to—and which in turn increases—the complicated structure of modern societies. The effects of state action in a primitive community are far more easily followed; the forms both of revenue and expenditure are reducible to a few simple kinds, directed by rude or partially developed agencies. The modern State, even when it allows an amount of individual liberty unknown in any former period, is obliged to employ complicated machinery for the regulation and management of its outlay and receipts. The results, moreover, are not so readily perceived; numerous interests and classes are affected by any change in the course of public expenditure or by readjustments of taxation. The many indirect results of financial processes must be considered before we can either understand their operation or fairly judge their merits; but to trace the action of economic forces in their effects on the highly developed systems of modern industrial societies is a task of considerable difficulty, not to be accomplished without the aid of general principles and careful reference to former experience. The case for a scientific study of finance is so strong that it does not require much vindication, and the value of critical investigations has been already proved by the results obtained.

§ 2. The scope of our subject has now been in-

dicated in a general way, but for clearness of thought and in consequence of the differing views of many writers of authority we must determine it more precisely. State expenditure and state revenue at once occur to the mind as the two great heads of inquiry, standing opposed to each other as Production and Consumption, or Supply and Demand do in economic science. Closer examination shows that this simple grouping does not exhaust the field of investigation. Problems of revenue and of expenditure are, indeed, the most important. Adam Smith, who was, at least for England, the founder of the scientific study of public finance, as of political economy in general, devoted separate chapters of his Fifth Book to 'The Expenses of the Sovereign' and 'The Revenues of the Sovereign'; but by the nature of the subject he found himself forced to add a third section, in which the relation between expenditure and receipts is examined. He knew that many ancient and mediæval sovereigns had accumulated treasures; it was apparent that most modern governments had heaped up debts—a process that has been carried much further since his day; and it followed that an inquiry into the balance between state incomings and outgoings was an essential, as well as difficult, part of public finance.

Nor is this the only addition. The phenomena to be dealt with do not admit of being conveniently grouped under Adam Smith's three heads. This difficulty is at once felt on calling to mind that the expenditure and revenue under consideration are *state* expenditure and *state* revenue. We must examine, not merely the processes, but also the mechanism by which those processes are carried on. For the collection and application of wealth by the State legislative and administrative action is needed. The right of voting supplies and supervising expenditure—'the power of the purse'—is one of the leading privileges of a representative body; it is also the most effectual safeguard of constitutional rights. Methods of administrative

control seriously affect the working of the national finances, and are deserving of attentive study. No financial treatise can be complete unless it considers the problems of 'the budget' and 'financial administration' (*Finanzverwaltung*), and such has in late years been the almost invariable practice.

In one respect the scope of public finance has been curtailed by some of its ablest expounders. French writers, more especially M. P. Leroy-Beaulieu, have refused to regard the problems of public expenditure as a part of their subject. The reason for this limitation is said to be the difficulty of scientifically determining the proper amount of state outlay, as that must depend on the functions assigned to the State. 'This kind of inquiry,' says M. Leroy-Beaulieu, 'does not in my opinion belong to the science of finance. . . . . A State has wants: it does not belong to us at present to know what they are, and what they ought to be, but how it is possible to satisfy them in the amplest manner with the least loss and sacrifice to individuals. If you engage a builder to build you a house, it is not his business to inquire if the building is too large for your income or your social position; what does concern him is to build the house in question with the utmost possible solidity, convenience and beauty, at the lowest cost to the owner. In like manner, a writer on finance can sincerely lament that States spend too much; but his real task lies in showing how a State can obtain supplies, while treating the interests of individuals with due tenderness and respecting justice.'[2] English writers have gone further in this direction, and, by disregarding all forms of State revenue except that derived from taxation, have replaced the

[1] That is, with Continental writers. In England these topics are generally relegated to works on 'Constitutional Law' and 'Parliamentary Usage.' Recent American works on Public Finance give considerable space to 'Financial Administration and the Budget.' See Adams, *Finance*, 103–218; Daniels, 315–324, 344–373; Plehn, 325–353.

[2] Leroy-Beaulieu, i. 2, 3.

broader treatment of Adam Smith and the Germans by treatises on 'Taxation' and 'Public Debts.'[1]

It nevertheless seems clear that the question of expenditure is just as much a financial problem as that of revenue. Neither in theory nor in practice is it advisable to separate them completely. The greatest finance ministers have made their reputations as much by judicious control of outlay as by wise reforms in respect to revenue,[2] while for theoretical discussion the principles and facts of expenditure are of considerable interest. M. Leroy-Beaulieu's suggested parallel of the builder is not in point, since the practical statesman is the only person to whom the illustration would apply, and he evidently does not act in conformity with it; the scientific student is only limited in his inquiries by the nature of the material that he is investigating. One admission may indeed be made. Questions of expenditure do not allow of quite as precise treatment as those referring to taxation, some parts of the latter subject permitting the use of lengthened deductions. This test of fitness for exact investigation would, however, exclude other large parts of the subject—*e.g.* 'the public domain'—which are nevertheless discussed by all recent writers, M. Leroy-Beaulieu included. For a complete inquiry into the theory of finance some consideration of the conditions governing State outlay is indispensable—*e.g.* the increase of military expenditure in European States, its causes and limits, cannot be left wholly unnoticed by any thorough student of public finance. Such an inquiry is more especially needed owing to the fact

[1] Cf. the title to J. R. McCulloch's well-known work, *Taxation and the Funding System*. So strong is the disposition in England and America to limit the subject of finance to taxation, that in the American translation of Cossa's useful *Scienza delle Finanze*, the title is changed into *Taxation: its Principles and Methods*.

[2] The statement of Turgot's policy in his *Letter to the King* (ii. 165): *Point de banqueroute, point d'augmentation d'impôts, point d'emprunts*, is a striking example. Also cp. Gladstone's remark, 'Good finance consists more in the spending than in the collecting of revenue,' West, *Recollections of Mr. Gladstone*, ii. 309.

that expenditure and revenue are connected. Public outlay is not something unchangeable and determined, to be met 'with the least loss and sacrifice to individuals.' Expenditure that would be legitimate in a lightly taxed State would be blameworthy in one that is heavily taxed. The aim of the statesman is not simply to distribute loss and reduce it to a minimum; it is rather to procure the maximum of advantage to the community, and to so balance expenditure and revenue as to attain that result.

The principal difficulty in the scientific examination of public expenditure is found when attempting to limit the mode of treatment. Some writers enter into discussions as to the legitimacy of certain state functions, and their relative urgency. Others simply state the forms and facts of public outlay, leaving further inquiry to the political theorist. In the present work, in accordance with the precedent set by Adam Smith, the several items of expenditure will be treated on a positive basis, and at the same time the considerations naturally arising from their existence, and the financial questions that they suggest will be noticed, though no complete examination of state functions will be attempted. Whatever theoretical questions may be raised, such seems to be the course that convenience suggests, and is one to which the subject naturally lends itself. Our object is to elucidate the principles of public finance; and the admission or exclusion of any special topic, as well as the extent of treatment in each case, must be determined solely by reference to that end.[1]

§ 3. Theoretical writers on finance, especially in Germany, have very fully considered the relations of their subject to cognate branches of knowledge, *i.e.* to the various social and political sciences, and have in particular laid stress on

[1] The omission of public expenditure as a topic in 'finance,' in the case of English writers, was perhaps in part caused by neglect of the economic theory of the 'Consumption of Wealth' with which it would naturally be connected.

the ties that bind it to economics.[1] In its origin financial science was a product of economic study. It appears either as a special section, or as the main subject of the older treatises of Political Economy, 'when considered as a branch of the science of a statesman or legislator,' to quote Adam Smith's phrase. In another aspect it may be regarded as belonging to administration, and as such formed a large part of the 'Chamber Science' (*Cameral-wissenschaft*) which was in Germany the precursor of scientific economics. The undue limitation of the scope of finance by English writers has led to its inclusion under the title of 'taxation' in the various systematic expositions of political economy,[2] and the more enlarged view taken by German writers has not prevented a similar result in that country, for since the time of K. H. Rau, political economy has been regarded as comprising, in addition to the general theory, the economics of special industries, economic legislation and administration, as well as public finance.[3] This apparent absorption of finance in economics is really the result of a peculiar conception. If the latter science be limited, in the manner usual in England and France, to an investigation of the laws governing the phenomena of wealth, it is beyond dispute that public finance cannot form a part of it, as political and fiscal conditions have to be recognised to an extent impossible in a pure science of wealth. Moreover, practical considerations have to be weighed in every department of finance. That political economy in the most extended use of the term may fitly include finance is indeed true, but then it would appear that this wider political economy is nothing more than a common name for the various

[1] *E.g.* Umpfenbach, 1–22; Roscher, § 5; Cohn, §§ 4–7; Wagner, i, 16–20.

[2] The works of J. S. Mill, Fawcett, and Shadwell may be given as examples.

[3] The treatises of Rau, Roscher, Wagner, and Cohn on Finance are all in name sections of works on 'Political Economy.' The collection of monographs on financial questions in the Schönberg *Handbuch* is another instance.

social and political sciences; it is in fact a rudimentary Sociology and Art of Politics combined.[1]

Though the problems of finance are really suited for treatment in a separate form, it does not follow that their relation to economics should be disregarded. On the contrary there is a close connexion, or rather series of connexions, between the two studies. State outlay is a part of the consumption of the society of which the State is the regulating organ, and for a knowledge of the conditions that govern it we must have a theory of the consumption of wealth in general. Unhappily, questions relating to consumption have been too much neglected by economists, and thus there is no complete theory available for application to financial problems. Still, the leading truths on the matter are suggested in modern economic theories, and may be developed by their aid. The management of state property, again, requires a reference to various economic doctrines, and more especially the industrial enterprises carried on under a public monopoly illustrate and are explained by the general theory of monopolies. It is, however, when we reach taxation that the aid of economics becomes most valuable. The merits of the general system of taxation, as also those of each special tax, have to be tested by the aid of economic principles. The important problem of justice in taxation is indeed an ethical one, but until its economic effects are known it is impossible to say whether any given form of taxation is just or the reverse. All the intricate points respecting the incidence of taxation can be handled successfully only by applying a sound theory of the distribution of wealth, and the effect of taxation on accumulation makes it necessary to constantly bear in mind the conditions of effective production. In another department of finance, the nature

[1] Examination of the works referred to in the preceding note will support the statement in the text. The financial sections of the treatises there mentioned are in fact independent, and may be studied quite apart from the other sections.

and effect of public loans can be best explained by the economic theory of credit, and such is the course usually adopted. An acquaintance with economic science is, it may be said, an indispensable part of the equipment of the student of finance.

§ 4. Close as is the relation between economics and finance, it is by no means exclusively to the former science that we have to look for aid when developing the latter. In a subject so inseparable from the State, it is in many cases necessary to recognise the action of political and administrative conditions. Financial problems are often the occasions on which constitutional issues are raised, and, as noticed above, they may make a line of conduct desirable, that from the purely economic point of view would be very objectionable. The same statement holds good of administration.[1] The whole system of finance must be kept in conformity with the general mode of managing the affairs of the State. This is, in fact, involved in the position that public finance belongs to the domain of political science.

The science of finance has another important auxiliary in history, which illustrates, verifies, and in some instances affords data for its principles. The material of financial study is not confined to that afforded by modern societies, and even for a true knowledge of actual conditions it is often necessary to be acquainted with their growth. No pure *a priori* system of finance can be successfully established. Each country has special features arising from its previous history and the sentiments of its people—in great part the product of historical forces. The most violent revolution cannot really break this connexion with the past.[2] As a consequence, a system admirably suited

[1] The determination of the comparative advantages of raising supplies by loans or by fresh taxation, the choice between different methods of levying taxes, and the need in certain cases of resorting to issues of inconvertible paper are instances.

[2] French financial history affords the best possible illustration. M. Stourm in his valuable work, *Les Finances de l'ancien Régime et de la Révolution*, has

for one country, may be quite unfitted for another. A comparison of the systems of the United Kingdom and of India shows at a glance extraordinary differences, and yet in each case the attainment of solid results. These obvious truths, however, suggest the need of a caution. The necessary varieties of financial practice do not show that general principles are unattainable, though they tend to render their application more difficult. The conclusions of financial theory ought to underlie all the special systems and regulations, but they require to be applied with most careful regard to the circumstances of time and place, and, above all, to the sentiments and habits of the people. Any form of expenditure or taxation that is peculiarly obnoxious has, by that fact alone, a strong presumption raised against it, to be rebutted only by very weighty reasons on the other side.

As history throws light on the evolution of finance, and enables us to confirm or to limit our general propositions by the evidence derived from previous times, so does statistics give us a firmer position in dealing with the present. Without correct information as to state revenue and expenditure, financial policy is little better than guesswork. In order to comprehend the effects of taxation it is indispensable to have full statistics as to the distribution of wealth among classes and among localities. Such materials as those collected by census agencies and statistical departments are necessary elements in any financial calculations, and their absence, of itself, suffices to explain the late origin of financial science. In no respect is modern administration so superior to that of ancient and mediæval times, as in the improved data on which it bases its estimates and makes its practical suggestions.

§ 5. From an examination of the various sciences that may assist the study of finance, we pass by a natural transition to the proper method of inquiry. In regard to

shown conclusively that the modern French system is developed from that existing before the Revolution. Stourm, *passim*, and especially ii. 501-2.

all the social sciences, and notably to economics, this question has been vigorously discussed, even to the neglect of the positive matter of research. The principles of scientific inquiry and the appropriate method of investigation belong in reality rather to logic than to the special sciences ; though the processes employed in discovery can only be adequately appreciated by those who are conversant with the particular branch in which they are used. At all events, it is clear that the disputes as to method have in many cases arisen from misapprehension as to the exact position of each of the contending parties. Protracted controversy has, however, finally led, if not to complete agreement, at least to a recognition of the common ground occupied by the disputants, and also, it may be said, to a belief that the whole question is, as has often been remarked, one of 'emphasis.' A difference in view is, in many cases, the result of personal tastes ; one writer places much weight on a particular method, another on a different and apparently opposed one, though both, if interrogated, would probably allow that each form of inquiry was valid within limits, the exact fixing of which would be the only point in dispute.[1]

The principal ground of debate was for a long period as to the claims of the 'inductive' and the 'deductive' methods to be regarded as the sole legitimate process of investigation. To that question it may be confidently replied that both are in particular cases valid and indeed indispensable. Without 'induction' in the wider sense of the term [2] no materials for study would be available : mere

[1] On this subject see Wagner, iii. 199, and his article in Conrad's *Jahrbücher*, 1886, i. 197 sq. ; Dunbar in *Quarterly Journal of Economics*, i. 1 sq. ; Marshall, *Principles of Economics*, Bk. i. ch. 5 ; also J. N. Keynes, *Method and Scope of Political Economy*.

[2] Cairnes's *Logical Method* (2nd ed.), 60 sq. The varying use of the term 'induction' by logicians has helped to increase the confusion as to the real relation of the inductive and deductive methods. Cf. J. S. Mill, *Logic*, Bk. ii. ch. 4, § 5 ; and Bk. iii. ch. 2, which contains his controversy with Whewell on this point.

observation without arrangement and generalisation is evidently worthless for scientific use. The particular form of induction which proceeds by comparison is frequently serviceable. The simple juxtaposition of two financial systems will sometimes throw a great deal of light on the conditions governing each. In this process history, as we saw in the preceding section, plays a great part, and it is thus quite correct to maintain that the science of finance is in one of its aspects 'inductive,' 'comparative,' and 'historical.'

But this, though the truth, is not the whole truth. The generalisations of economics and the permanent facts of human nature enable us to draw important conclusions as to the effects of certain forces in their bearing on finance. The whole theory of the shifting and incidence of taxation is and must be 'deductive,' *i.e.* it must be developed from simple conditions by logical trains of reasoning. Deduction, too, is needed in order to ascertain the effects of public indebtedness as well as to trace the ultimate results of public expenditure. It must be remembered that in all these cases verification by appeal to facts is required, but the process of verification is admittedly one of the component parts of the deductive method. On the whole, the study of finance will force on us the conclusion that 'induction' and 'deduction' are not so much opposed, as complementary, methods, each remedying and making good the weakness of the other.

The preceding argument holds, to some extent, of even the most extreme forms of the two methods. Thus, some —as Macaulay—have maintained that experiment is the really fruitful form of social inquiry. Now, though it is evident that, strictly speaking, experiment is impossible in respect to any part of social life, since we cannot bring about that isolation of a particular phenomenon without which no experiment can be conclusive, it yet seems true that a modified form of experiment may give a probable

result that will, in some cases, prove of great practical use. Thus in finance, each change of taxation may be regarded as an experiment in the popular sense; if, to take an instance, it appeared that a reduction in the rates of taxation on commodities so stimulated consumption that the loss in revenue through the reduction was made up by the increase in the quantities used, it might fairly be said that the policy of reducing duties was experimentally justified, notwithstanding that the logical conditions for experiment were absent. We must, however, notice that a result of this kind cannot safely be extended to fresh cases unless it is supported by more general considerations.[1]

The advocates of the mathematical method stand at the other extreme. There is, at first sight, something absurd in suggesting so exact a mode of inquiry in a subject where very many complications exist, and where each fact is dependent on a number of circumstances, but in those parts of finance in which deduction is the best instrument of research it may prove convenient to arrange the steps of reasoning in a mathematical form; the problem will perhaps be thereby more easily solved, or its exposition more readily followed.[2] Where the conditions can be sufficiently simplified, and where it is important to develop the quantitative results, this procedure is probably advisable.[3] It is, however, at best confined to a very limited area, and needs to have its conclusions tested by the best

[1] For this loose use of experiment, cf. Jevons's 'Experimental Legislation' in *Methods of Social Reform*, 253 sq.; also Newmarch, *Address to British Association* (section F), 1861.

[2] It is interesting to notice that one of the earliest attempts to apply mathematical methods to social questions was in regard to the theory of taxation by Canard in his *Principes d'Économie Politique*, Paris, 1802.

[3] See for good examples of the method, Cournot's inquiries in his *Recherches Mathématiques*; Auspitz und Lieben, *Untersuchungen über die Theorie des Preises;* M. Pantaleoni, *Teoria della traslazione dei tributi;* and Fleeming Jenkin, 'The Incidence of Taxes,' *Collected Papers*, ii. 107–121. Prof. Edgeworth's brilliant researches on 'The Pure Theory of Taxation,' *Economic Journal*, vii. 46–70, 226–228, 550–571, may be specially noticed.

statistical results available. The more concrete problems of finance are entirely unamenable to this rigid and precise method of treatment.

§ 6. Having thus briefly considered the questions preliminary to the study of public finance, it only remains to give an outline of the course of our further inquiries. After a very concise account of the historical development of financial science (Introduction, Chapter II.) we shall take up the subject of public expenditure and its principal problems (Book I.). Next in order of treatment will come the public revenues, and first what may be described as the economic and industrial receipts of the State and their subdivisions (Book II.). The examination of these more primitive forms of revenue will lead up to the discussion of taxation. Owing to the great extent and complexity of this topic it will be expedient to devote a separate book to the general problems of taxation (Book III.), reserving the study of the several taxes for distinct treatment in Book IV. The questions relating to revenue having been thus disposed of, Book V. will deal with the balance of expenditure and receipts, or, in other words, with public treasures and public debts; while the mechanism, administration, and control of the financial system will form the subject of a final book (Book VI.).

In order to emphasise the close connexion that exists between general and local finance, the matter usually collected under the latter head has been distributed among the different divisions of the work. Thus local expenditure is examined in Book I., local economic revenue in Book II., the principles of local taxation in Book III., and in like manner the tax forms, the indebtedness, and the financial mechanism of subordinate political bodies are discussed in the books dealing with those parts of public finance.

CHAPTER II

§ 1. SOME conception of the gradual formation of the modern theory of finance, and of the steps by which it has assumed its present shape, will enable the student to form clearer ideas as to its relation to other branches of social inquiry, and the real meaning of those parts of earlier systems which at present seem to have little or no justification. It is only by tracing the history of speculative thought on the various problems of public finance that we can fully understand the way in which errors have been gradually eliminated, and incomplete doctrines have been so expanded as to embrace a larger portion of truth.

There is a more special reason for this preliminary historical inquiry in regard to social and political sciences. The particular stage of social development peculiarly affects such studies; their cultivators are not merely like those of all sciences influenced by the knowledge and ideas of their age, but the very phenomena to be interpreted are themselves produced by, and dependent on, the condition of society. It is this feature which alone can fully explain the absence of financial theory at periods of apparently high civilisation and culture.

Our historical inquiry has at present to be limited to what is known as the 'external' history of the science of finance, *i.e.* to an outline of its general aspect and leading representatives at each stage of its growth. Its 'internal' history, which considers the origin and growth of the

separate doctrines of finance, will be more fitly treated in the systematic sections of the work.

§ 2. In classical antiquity, though the need of revenue was often a pressing one, and though at least under the Roman Empire financial administration was elaborately organised,[1] there is no appearance of a scientific treatment of financial problems. The nearest approach to discussion of such questions is found in the little work on the *Athenian Revenues*, formerly attributed to Xenophon, and modern research has succeeded in collecting stray passages from classical authors that incidentally deal with financial questions.[2] There is no great difficulty in accounting for this neglect. The causes which prevented the development of economics equally hindered that of finance. The whole constitution of the societies of Greece and Rome was based on conceptions directly opposed to those under which our modern doctrines have been formed. With them the State was placed above and before the individual, who was bound to sacrifice himself unreservedly for his country. To persons holding such a belief the question of just taxation would appear to be of trifling importance. That one man was asked for 20 per cent. of his income, while another escaped with a payment of 10 per cent., would not concern those who regarded all revenue as due in case of need to the State. The views of these ancient societies in respect to public expenditure and credit were vitiated by the same notion of State omnipotence.[3] The whole organisation of classical

[1] The parts of the Theodosian Code dealing with administration are our principal source of information as to the financial system of the later Roman Empire. See, for a lucid exposition of the mechanism of Roman finance, Humbert's *Essai sur les Finances et la Comptabilité publique chez les Romains* (Paris, 1886, 2 vols.). The standard work on Athenian finance is Boekh, *Staatshaushaltung der Athener* (3rd ed. by Fränkel, 1887). A considerable amount of information respecting the tax system of Egypt has been obtained, and much more may be expected, through recent investigations. See Wilcken, *Griechische Ostraka aus Ægypten und Nubien.*

[2] *E.g.* Tacitus, *Ann.* 13, 31; Pliny, *Pan.* 37.

[3] See De Coulanges, *La Cité antique*, Bk. iii. ch. 18, for a powerful state-

society tended to confirm this belief; both in Greece and Rome, war, and its product slavery, were regarded not simply as permissible, but as praiseworthy. Free industry was consequently placed at a disadvantage, and the retardation of economic development which inevitably resulted did not allow of the existence of those institutions through whose agency public revenue and credit can alone be successfully promoted. It requires some knowledge of economic forces to see that State finances depend ultimately on the production of wealth by individuals, and that without security, and a just division of public burdens, it is impossible to expect the continuous growth of the source from which all income, public and private, comes, viz. the effective application of labour, natural agents, capital and invention to the task of production. The history of the fall of the Roman Empire is but one long illustration of the danger of neglecting a proposition so obvious to any modern.[1]

§ 3. The mediæval period shows quite as little trace of financial theory, while the actual organisation of administrative agencies is much inferior to that of the later Roman Empire. On its financial side the so-called feudal system exhibited a surrender of the public claims in favour of the principal lords. Some parts of the Roman arrangements survived, but they were gradually transformed until the sovereign at last had to depend on his own property for support, with whatever supplement might be derived from the fees that he obtained. It necessarily followed that —even were the intellectual conditions favourable—no developed financial theory was possible. The administration of the royal income forced the officials of the feudal

ment of the classical ideas respecting the relations of the individual and the State.

[1] For the causes hindering the rise of economic science, see Ingram, *Hist. of Pol. Economy*, 7–9; for Roman ignorance of the principles of taxation, cf. Merivale, *Romans under the Empire*, viii. 356; and for the obstructive effects of the methods employed by the Empire, Guizot, *Civilisation in France*, Lect. 2; Clamageran, *Histoire de l'Impôt en France*, i. 89 sq.

State to attend to the details of financial procedure, but of theory or even precise knowledge there is no appearance.[1] The first traces of a revival of method in practical finance are found in the German and Italian cities, which in many respects were free from external control. It is in them, too, that we find the first attempts at theoretic discussion, which, indeed, were the natural outcome of their greater economic activity. Specially noteworthy are the Florentine controversies respecting progressive taxation with their partial anticipation of modern views.[2]

§ 4. The dissolution of the Middle Age economy both in state and private life, and its replacement by the modern system, mark the time at which finance as a theoretic study first became possible. The political writings of the preceding period were under theological influence, and even those of the fifteenth and the opening of the sixteenth century, more especially those of Macchiavelli and Sir Thomas More, were limited by their dependence on the ideas of classical writers. But the firmer organisation of the centralised monarchies of France, Spain, and England, the development of money dealings, and the revolution in economic relations produced by the supplies of the precious metals from the New World, presented to reflective minds a series of problems which could not be solved without the aid of wider conceptions; and accordingly we find that the latter part of the sixteenth century exhibits a new development of social and political inquiry. The most prominent representative of this movement is the French writer Bodin (1530–1596), whose *Republic* appeared in French in 1576 and in a more complete form in Latin in 1586. Apart

[1] The *Dialogus de Scaccario* in Stubbs's *Select Charters*, 168–248, shows the processes of the English Exchequer. See also H. Hall, *Antiquities of the Exchequer*.

[2] For one example of mediæval city finance, see Schönberg, *Finanzverhältnisse der Stadt Basel im* 14. *und* 15. *Jahrhundert*. For some features of Florentine finance, see Seligman, *Progressive Taxation*, 22 sq., 70. The most remarkable Florentine writers were Palmieri, Guetti, and Guicciardini the historian.

from its general treatment of political science, the second chapter of the sixth book of the work contains an examination of the various forms of the public revenue; they are grouped under seven heads, the most important being (1) the public domain, (2) import and export duties, and (3) direct taxation. In accordance with the ideas of the mercantile system, Bodin approved of customs both on imports and exports, but he distinguished between 'raw materials,' and 'manufactured articles,' advocating high export dues on the former, and high import ones on the latter. Direct taxes should, he thought, be resorted to only in case of necessity, and then should be proportioned to 'faculty.' Taxes on luxury he regarded with special approval. He condemned the many exemptions from direct taxation which existed in the France of his time, and advised a census to enable charges to be proportioned to property. His influence can be traced in the German financial writers of the next century.[1]

§ 5. The predominance of the set of conceptions usually described as 'Mercantilism' is the principal condition affecting the growth of finance in the seventeenth century. Political economy came into existence as a collection of practical rules for the guidance of statesmen.[2] In this aspect it is described by Adam Smith, who states that it 'proposes two distinct objects; first to supply a plentiful revenue or subsistence for the people . . . . and secondly to supply the State or Commonwealth with a revenue sufficient for the public service.'[3] The latter or financial aim was particularly developed in Germany. Not to dwell on the writers on 'the Treasury' and 'on Taxes' in the seventeenth century, who show some advance on the

[1] The fullest account of Bodin is in Baudrillart's *Jean Bodin et son Temps* (Paris, 1853). His views on taxation are described by Clamageran, ii. 314–330. For English readers, Hallam, *Literature of Europe*, Part ii. ch. 4, § 2, may be noticed as giving a convenient summary.

[2] Such was the work of Antoine Montcrétien, *Traicté d'Économie Politique* (1615), a series of counsels addressed to Louis XIII.

[3] *Wealth of Nations*, 173.

views of Bodin,[1] there was the 'Chamber Science' of the eighteenth century, which presented its highest form in the works of Justi and Sonnenfels. The former writer discussed financial questions both in his *Staatswissenschaft* (1755) and his *Finanzwesen* (1766). He held that taxation should be proportioned to property, and is credited with the creation of a theory of the so-called *Regalia*, but his real service seems to have been the placing in systematic order the views prevalent in his day on the various parts of public finance, and giving such matters a prominent place in an exposition of political science.[2]

In France financial topics received a different treatment. The organisation of the absolute monarchy, the wars which accompanied it, and the elaborate and many-sided commercial policy of Colbert's administration (1661–1683) brought about a state of things that effectively marked out the line of thought on such problems. The extraordinary brilliancy and apparent prosperity of the State contrasted so forcibly with the extreme misery of the people as to give reason for believing, either that the distribution of taxation was unjust, or that its amount was excessive. The French people, in fact, suffered from both these evils, and it was in the advocacy of a reformed tax-system that the first efforts of the dissentients from the prevailing mercantile doctrine were made. Vauban's *Dîme Royale* (1707) presents a melancholy picture of the condition of France, and suggests the reform of taxation by abolishing most of the existing taxes and their replacement by his proposed 'royal tithe'—a single direct tax of 10 per cent. on all classes. Here we notice a complete departure from

[1] The most remarkable of these writers are Faust, Conring, and Klock. An attempt has been made by Stein (i. 125, and *Finanzarchiv*, i. 1 sq.) to prove that the last-named was 'the true founder of the theory of taxation,' but the bulk of his work seems not above the ordinary mercantile position, and his views on taxation are derived from Bodin. He has been further accused of copying from the earlier work of Faust. See also Roscher, *Geschichte*, 210 sq.

[2] For Justi, see Roscher, *Geschichte*, 444–465; for his Finance, 461–465; also Cohn, §§ 9, 71; Meyer, 16–17; Wagner, i. 35–6.

the more superficial view of the earlier writers, who especially approved of taxes on commodities as encouraging industry, and a clearer appreciation of the real pressure of taxation. Boisguillebert, both in his *Détail de la France* (1697) and his *Factum de la France* (1707), maintained somewhat similar views, more particularly as to the superiority of direct taxation. Both may be regarded as precursors of the advocates of the direct single tax in the eighteenth century. In a different part of finance, and at a later time, Montesquieu contributed some additions to the received views. The 13th book of the *Spirit of Laws* (1748) is devoted to an examination of the political side of taxation and to a criticism of several existing taxes. He is strongly in favour of progressive taxation, influenced probably, as M. Sorel has remarked,[1] by the practice of the Athenians. It is, however, in showing the relation of the financial system to the political constitution of each country that Montesquieu is at his best; his views were evidently formed from his study of the English Constitution, which provided more efficient safeguards for the interests of the subjects than were to be found in any continental State.[2] In other respects the study of financial problems had not claimed much attention in England. The pamphlet literature of the seventeenth century had handled certain special points, but the pressure of taxation was not such as to lead men to look for remedies against its evils. The rise of statistics under the name of 'political arithmetic' gave an impetus to the examination of the facts of finance, especially in the numerous works of Sir W. Petty, who, in company with Locke, considered the question of incidence in taxation. The question of public credit was discussed by Davenant and the proposals of Decker and Vanderlint for the establishment of a single tax are worthy of note as marking the

[1] *Montesquieu*, 108.

[2] See the texts of Vauban and Boisguillebert in *Les Économistes Financiers du XVIIIme Siècle* (ed. Daire). Also Ingram, 57–9. For Montesquieu, cp Stein, i. 131–2.

tendency of thought.[1] Two of Hume's *Political Essays* (1752) are devoted to 'Taxes' and 'Public Credit.' They show traces of the teaching of Montesquieu on the political effects of financial regulations, but also a far greater knowledge of the economical influence of taxation and credit. The Physiocratic doctrine of the incidence of taxation was rejected by Hume, as was also the popular view that national debts were beneficial. A few years later than Hume's *Essays* appeared the *Principles of Political Economy* of Sir James Steuart (1767), embodying the teaching of the English mercantilists in a systematic form. The destruction of the system which it advocated prevented the work acquiring any influence or even general reputation, though some of its discussions of finance are interesting and suggestive.[2]

§ 6. The changes in the tone of thought on economic questions and the position of society facilitated the establishment of the first scientific school of social philosophy—the famous group or 'sect' of '*Économistes*.' Most of their views are to be found in germ in earlier writers, but they have the merit of presenting them in a definite form. It concerns us particularly to notice that one of their cardinal doctrines—the '*impôt unique*'—was a financial one, and that financial questions occupied a great deal of their attention. However widely modern writers on finance may differ from the Physiocratic conclusions, they must at least allow that their selection of problems was a good one. With very defective information the '*Économistes*' sought to determine the question of justice in taxation—its real as opposed to its apparent incidence, and its effects on the growth of national wealth; their analysis of the sources of revenue and of the extent to which each could contribute

[1] On these minor writers, see Ricca-Salerno, *Le Dottrine Finanziarie in Inghilterra;* also Vocke, *Finanzarchiv*, vii. 56.

[2] The most important parts of Steuart's *Principles*, so far as finance is concerned, are—Book iv. part 4 (Public Credit), and Book v. (Taxes). For a good, but too favourable account of Steuart's financial doctrines, see Hasbach, *Untersuchungen über Adam Smith*, Book ii. ch. 4, 1st section.

to the public requirements, though not correctly worked out, yet indicated a fruitful line of research for later inquirers. The founder of the school—Quesnay—has discussed taxation in his *Second Problème Économique*, and several of his *Maximes* refer to finance. The elder Mirabeau, one of his most ardent disciples, published a treatise on 'taxation,' and all the members of the group adopted the belief in the superiority of direct taxation on the net product of land, though admitting the temporary use of other taxes.[1] By far the most illustrious member of the school—though in some particulars he dissented from their doctrines—was the statesman and philosopher Turgot (1727–1781), who in his numerous papers on questions of finance has shown an amount of practical insight combined with theoretic power that his successors have rarely equalled.[2]

The influence of the Physiocrats on financial practice was slight, but it appears that the Constituent Assembly (1789-1791), under the guidance of Du Pont de Nemours, sought to realise in part their idea of a tax on the 'net product' from land. Their action on the progress of speculation has been much more powerful; the form of many financial problems in modern times can be traced back to their teaching, and their leading conceptions have affected the *Wealth of Nations*.[3]

§ 7. The great reputation and the permanent merits of

[1] See *Physiocrates* (ed. Daire), 128, or Oncken's *Quesnay*, 696, for the *Second Problème*. Of the *Maximes*, Nos. 5, 27, 28, 29, 30, relate to finance. For the latest views of Quesnay's position, see S. Bauer, 'Zur Entstehung der Physiocratie'; Conrad's *Jahrbücher*, August 1890; and *Quarterly Journal of Economics*, v. 100 sq.; also Schelle, *Du Pont de Nemours* (Paris, 1888). The general doctrines of the Physiocrats are described for English readers by Mr. Higgs, *The Physiocrats* (1897); their theory of incidence is well explained in Prof. Seligman's *Shifting and Incidence of Taxation* (2nd ed. 1899), 95–112.

[2] See *Œuvres de Turgot* (ed. Daire); for finance more especially, i. 389–632; ii. 368–432, but financial questions are often noticed by him when treating of other matters. On his differences from Quesnay, see Schelle, 127 sq.

[3] For the influence of the Physiocrats on the financial system of the Revolution, see Stourm, i. 128–130, ii. 2–11; Schelle 319 sq

Adam Smith's economic and financial work have led to a perhaps undue depreciation of the services rendered by his predecessors, but it is hardly questionable that in finance, as in economics, the *Wealth of Nations* was far superior to any earlier work, and its superiority in each case was due to the same qualities. The fifth book—which considers 'the expenses and revenue of the Sovereign' shows comprehensiveness of view, felicity of illustration, and thorough understanding of the practical aspects of financial problems, while the looseness of arrangement, which has been so often censured, is less evident here than in the earlier parts of the work. It is quite possible for critics, irritated by the lavish praise bestowed on Adam Smith by the less intelligent of his followers, to show that most of his views have been set forth by others at an earlier time; the Physiocrats may have had a firmer grasp of the narrower premises from which they reasoned; the technical side of finance may have been more exhaustively handled by the trained officials of the German States; but the establishment of any or of all these propositions does not invalidate Adam Smith's claim to be the greatest of theorists on finance.[1] Not only does he stand in the centre of financial development, summing up and co-ordinating the work of the preceding century in its various lines, and determining the future course of scientific thought: he further contributed an important element to the science of finance in his recognition of its close connexion with the theory of economics. It was by bringing out clearly that the solution of such questions as the incidence of taxation depended on the economic theory of the distribution of wealth[2] that he affected the progress of the science. Moreover, it was a renovated political economy which he applied as a solvent for some of the most difficult of financial problems. His assaults on the mercantile system effectually deprived it of any claim to be the accredited economic doctrine of Euro-

[1] Cp. the judgment of Prof. Hasbach, *Untersuchungen*, 220–98.

[2] Cp. Book i. chap. 6 (22), with Book v. chap. 2, part 2 (347).

pean thought, and replaced it by a more accurate body of principles influenced by far different views. The State appeared as but one among the several claimants on the national revenue, which was the product of individual energy and prudence, not of the paternal wisdom of statesmen. This alteration of aim at once limited and rendered definite the province of finance; instead of the constant regulation and encouragement which Colbert deemed necessary for national prosperity, the problem was narrowed down to maintaining the natural conditions of society, and applying state revenue to that comparatively simple object. Questions of finance came thus to occupy a larger share of attention than could be bestowed on them when industry, art and morals were also subjects for the sovereign's constant watchfulness and care. It may have been, as many German writers have argued,[1] that this doctrine bears the marks of exaggeration usual in all reactions, though their view of the case is not completely established; but when a comparison is made of the work of those who came under Adam Smith's influence with the systems that preceded the appearance of his treatise, we can say that any possible loss through 'radical' or '*doctrinaire* dogmatism' is far outweighed by the removal of perplexing fallacies and the establishment in their place of broader and more philosophical principles. Finally, the value of each part of the *Wealth of Nations* is so bound up with that of the substance it contains that it is only in studying the actual doctrines of finance that we can form a satisfactory judgment on its position.

§ 8. The *Wealth of Nations* was speedily translated into the leading European languages, and exercised a powerful effect on the development of financial doctrine; but the nature of its influence varied with the condition of the different countries in which it was studied. In England, where its action on practice, at first great, was retarded by

[1] Cohn, §§ 11–12; also his *Grundlegung*, §§ 74–79; Geffcken, in Schönberg, 22; Wagner, i. 40–1; also Ingram, 107-9.

the outbreak of the French Revolution and the unreasoning conservatism which the excesses of the Jacobins confirmed in the minds of the ruling classes,[1] the principal stimulus to speculative thought was found in his analysis of the operation of taxation on national wealth. This part of his work was further developed in Ricardo's *Principles of Political Economy and Taxation*, where it naturally found a place as an application of the revised theory of distribution in a peculiarly rigorous and abstract manner.[2] This tendency to abstraction led to a division of the treatment of financial questions that proved very unfortunate for the progress of the science. Writers on political economy contented themselves with general and rather vague discussions as to the influence of taxes, while the facts of the existing system were criticised or defended in numerous pamphlets of ephemeral interest. Even works of greater merit, such as Parnell's *Financial Reform* (1830) and Sayer's *Income Tax* (1833), suffered by the separation. The nearest approach to a combination of the different aspects of finance was made by McCulloch in his work on *Taxation and the Funding System* (1845, 3rd ed. 1863), in which the defects are more apparent to modern readers than the merits which at the time it undoubtedly possessed.

French economists and financial theorists were more impressed by the negative side of Adam Smith's teaching, a tendency that was much strengthened by the works of J. B. Say—*Traité d'Économie Politique* (1803), and *Cours Complet* (1828)—who was disposed to undervalue the

[1] The contrast between the liberal policy pursued by the younger Pitt in the earlier years of his administration and his later measures is very marked. Examples belonging to our subject are the Commercial Treaty with France in 1786 and the consolidation of the Customs Laws.

[2] Ricardo, chaps. 8–18 inclusive. See Wagner, ii. 333, and Cohn, § 248, for recognition of his work in this respect. In another department of finance, R. Hamilton, by his work on *The National Debt*, developed and added to the arguments of Adam Smith, and was followed by Ricardo. Sir J. Sinclair's *History of the Public Revenue* (1785, 3rd ed. 1803) deserves mention for its careful treatment of facts and the acquaintance shown with foreign literature on the subject.

services of the State even in the discharge of its necessary functions. The very complicated financial system of France has, however, led to its study from the administrative point of view, and special financial questions have received much more attention from French than from English economists. There are numerous treatises on 'Taxation' and 'Public Revenue,' marked by a general disposition to lay stress on the principles of natural right and justice as against economic expediency. Most French writers also exhibit a strong dislike to any financial measures believed to savour of socialism, *e.g.* progressive taxation, or even an income-tax. With rare exceptions—such as the work of Canard already mentioned, and the remarkable studies of Cournot—they show little taste for deductive reasoning or for the discussion of questions like that of the incidence of taxation which needs its use. On the other hand, they are prolific in historical and statistical works such as those of Vuitry, Clamageran, Stourm, De Parieu, Vignes, Audriffret, and Gomel; the great *Dictionnaire des Finances* (2 vols., 1894), issued under M. Leon Say's superintendence, is a storehouse of materials on French financial administration. In the convenient work of Garnier, *Traité des Finances* (4me éd. 1883), and the more brilliant treatise of Leroy-Beaulieu, *Science des Finances* (6me éd. 1899), they have text-books of a high order, the last-mentioned work in particular being remarkable for fulness of information and lucidity of style. Up to the present the dislike to state action is a distinctive note of French financial work, and in this respect it furnishes a useful corrective to the doctrines prevalent in Germany.

§ 9. The introduction of the doctrines of the *Wealth of Nations* into a country where the older traditions of the 'Chamber Sciences' were so strong as in Germany, brought about a re-casting rather than an abandonment of the earlier methods. The masses of material which writers in conformity with previous usage continued to

bestow on their readers were presented from the new point of view. Financial questions were either examined in special works, or were assigned a separate place in general economic treatises under the title *Finanzwissenschaft.* Passing over the less important works of the early part of this century,[1] we come to the treatise of K. H. Rau on *Economics*, the third volume of which, devoted to finance, appeared in 1832 (5th ed. 1864). The merits of Rau's writings lay in the fulness of their information, and in their systematic arrangement, both of which admirably fitted them for use by students, who obtained a general view of the science as accepted at the time. His influence in promoting the study of economics and finance in Germany was great, though often forgotten by his successors.[2] Discussion of his doctrines belongs to the treatment of the science, but we may just note his separation of "fees" (*Gebühren*) from 'taxes' (*Steuern*), and his recognition of the influence of administration in finance. The monograph of Nebenius on *Public Credit* (2nd ed. 1829), is entitled to a place beside Rau's more comprehensive work, as giving a full treatment of one of the most disputed financial topics. Somewhat later in date is Hoffmann's *Theory of Taxation* (1840), which has been adversely criticised by Roscher and Wagner on account of its unsystematic character, but which nevertheless has had considerable effect on the progress of finance. It appears to aim at giving a scientific justification of the contemporary fiscal policy of the Prussian State. Many other German writers will require attention in connexion with special doctrines, but the older school that was more or less closely limited by the traditions of Adam Smith's teachings in the shape in which they had been arranged by Rau, presents but one more name for consideration at present—Von Hock, who

[1] Among those who may be mentioned are Harl, Krehl, Fulda, and more especially Jacob (*Finanzwissenschaft*, 1821) and Malchus (*Finanzwissenschaft*, 1830).

[2] See Roscher, *Geschichte*, 847 sq.

examined in separate works the financial systems of France (1857), and of the United States (1867), and also wrote on *Public Revenue and Debts* (1863). This work includes in brief compass the leading questions of taxation and indebtedness; it is specially good, as might have been expected from the production of a trained official, in its discussion of administrative points.[1]

So far the development of finance in Germany had been carried on in conformity with the conceptions of Adam Smith and his followers, though modified in some degree by the peculiar conditions of the country; but towards the middle of the century, new forces began to act on the social sciences, which had considerable effect on their methods and doctrines. Among the agencies that more particularly influenced financial studies, we can indicate three, viz. (1) the rise of the 'historical' school, (2) the disposition to treat finance as a part of administration (*Verwaltung*) in the newest sense of that term, and (3) the advocacy of politico-social, as opposed to purely financial, aims in fiscal matters. The historical economists did not contribute much to the substance of financial doctrine, but the importance attached by them to distinctions between the different stages of social life, and their assertion of the impossibility of laying down universal precepts, were evidently applicable with peculiar force to the systems of taxation existing in different countries. The belief that the present could be fully understood only in the light of the past made it desirable to study the history of financial arrangements, and some of the best German work has been in this direction.[2] Some supporters of the school, in particular Schäffle and

[1] For fuller examination of the German writers of this period, see Wagner, i. 44–5, ii. 7–9, 11–12; Meyer, §§ 6–9, 13, 17, 18, 19; Vocke, *Abgaben*, 10–33; Falck, *Lehre von der Steuerüberwälzung*, 104–144.

[2] Such as the already mentioned work of Schönberg, *Finanzverhältnisse der Städt Basel* (1879); Schmoller, *Die Epochen der preussischen Finanzpolitik*; Zeumer, *Die deutschen Städtesteuern*; Vocke, *Geschichte der Steuern der brit Reiche.*

Schmoller, went further and assailed such cardinal doctrines of received financial theory as that of 'net income being the sole fund on which taxation could fall,' and this questionable position was supported by arguments which led to a closer study of fundamental financial principles.[1] To Stein is due a movement towards regarding finance as a problem of administration. His *Finanzwissenschaft* (5th ed. 4 vols., 1885–6), much modified and expanded in its later editions, contains, along with a great deal that is disputable and fanciful, a full treatment of financial organisation. The State with its administrative organs is in his view the basis of the financial system, and the history and statistics of the various European countries receive considerable attention. More important, from a practical standpoint, than the influence of Stein, is the tendency to regard the financial system as an agency for redistributing wealth. This position, supported most prominently by Wagner,[2] is not fully accepted by other economists and financial writers, but in several works propositions are set forth which need this politico-social view as their logical basis.

The result of these several influences has been to give a special tone to German financial work, since even where the newer ideas are not accepted, they are present to the writer's mind. This change in attitude towards financial problems is the outcome of beliefs which may briefly be enumerated as follows: (1) Public finance is a matter of national interest; it is not merely a distribution of burdens among the individual citizens, who owe duties to the State which it ought to be their privilege to discharge; (2) Financial administration is largely dependent on national peculiarities; each country has, or needs, a system suited to itself, so that the idea of a single 'rational' system of taxation is absurd; (3) The same

[1] Schäffle, *Gesammelte Aufsätze*, i. 158–183, esp. 167 sq.; Schmoller, 'Die Lehre vom Einkommen' (*Zeitschrift für Gesammte Staatswissenschaft*, 1863).

[2] Especially i, 48–50, ii. 449.

conception of relativity applies to the history of finance; earlier systems, *e.g.* the Roman, have to be judged in relation to the circumstances of the age in which they existed.

Instead of attempting to criticise the opinions and tendencies just described, we have rather to notice the remarkable productiveness which has been the outcome of the study of finance in Germany. Either in respect to general text-books and manuals or to monographs on the most complicated questions she holds the first place. Of the former, in addition to the previously noticed work of Stein, there are: the very extensive treatise of Wagner—still incomplete—in which each aspect of finance is handled at even undue length; the shorter and more lucid work of Cohn, where the evolution of financial systems is brought out by description rather than by brief and precise propositions; the less attractive manual of Roscher, which, however, gives a collection of the various opinions and a mass of interesting historical detail; the compact and conservative work of Umpfenbach, exhibiting some of the best qualities of the older writers; the concise manual of Eheberg (5th ed. 1898); the somewhat abstract and peculiarly arranged introductory book by Vocke (*Grundzüge der Finanzwissenschaft*, 1894) and lastly the *Outlines* of the subject by Conrad. Almost reaching the character of general manuals are the more limited treatises of Schäffle, (*Grundsätze der Steuerpolitik* 1880: *Die Steuern*, 1895; 1897) Neumann, Sax, and Vocke (*Abgaben, &c.*, 1887). Among special works there is the collection of monographs in the third volume of Schönberg's *Handbuch*—which had best be regarded in that light—and numerous smaller studies on such questions as 'progressive taxation' (Neumann), 'incidence of taxation' (Falck, Kaizl) 'justice in taxation' (Meyer), 'the exemption of the minimum of subsistence' (Schmidt). When the abundant periodical literature appearing in the journals of Conrad, Schmoller, and Schanz—the last devoted exclusively to

finance—is added, we can form some idea of the activity of German workers in this field.

§ 10. At a comparatively early period questions relating to public revenue and expenditure had attracted attention in Italy. The work of Broggia (1743) has been described as 'the earliest methodical treatise on taxes'; and several of the economists of the latter half of the eighteenth century examined the effects of taxation, and especially of those taxes actually levied in their country. The influence of Adam Smith and J. B. Say was for some time predominant in Italy as elsewhere. The development of financial science in Germany has, however, deeply affected Italian students, who have zealously devoted themselves to the examination of financial subjects, bringing to bear on their selected topics considerable independence of mind, and at the same time a thorough acquaintance with what has been already accomplished.[1] Amongst general works may be noticed the condensed outline by L. Cossa (7ma ed. 1896) a short treatise by Ricca-Salerno, written under the influence of the Austrian theory of value, the larger manual of Flora, and the more important and comprehensive treatise of Graziani (*Instituzioni di Scienza delle Finanze*, 1897), which may fitly rank with the best text books of other countries. The fundamental principles of finance have been examined by Viti de Marco, Mazzola, and Zorli, in common with the theory of marginal utility. In like manner the difficult problems of shifting and incidence have been investigated by Pantaleoni and Conigliani; and studies on progressive taxation have been made by Mazzola, and Martello, and in a specially elaborate form by Masè, Dari. The problems of 'double taxation' (Garelli), and the tax systems of federal states (Flora) have also been considered. Questions of local taxation have attracted attention and been con-

[1] For further details see Cossa, *Introduction to the Study of Political Economy*, ch. 15; also his *Scienza delle Finanze* (Bibliographies); Ricca-Salerno, *Storia delle dottrine finanziarie in Italia* (2nd ed. 1896).

sidered in the monographs of Alessio and Lacava, but more thoroughly in the very complete work of Conigliani (*La Riforma delle leggi sui Tributi Locali*, 1898). Alessio has also supplied a standard treatise on Italian finance. When the special articles in the *Giornale degli Economisti* and other journals are added, it may be said that Italy ranks next to Germany in the production of scientific works on finance.[1]

§ 11. The increased attention paid to economic and financial study has led to fuller recognition of the work done in other European countries. Thus the contributions of Dutch writers to finance, especially those of Pierson and Cort van der Linden, have been brought into notice. Spain has supplied a meritorious general treatise on finance in the work of Piernas Hurtado (*Tratado de Hacienda Pública*, 1st ed., 1869, 5th ed., 1900—1901), the second volume of which deals with the history and actual conditions of the Spanish finances. The Swedish writer Wicksell has made valuable contributions to the theory of incidence, and the history of Swedish finance. What Maine has aptly called "the unfortunate veil of language" shuts off Russian and other Sclavonic writers on finance, unless where, as by Bésobrasoff and Bloch, French has been used as the medium, or where, as with Kaizl's *Finanzwissenschaft* (1900—1), a German translation has appeared.[1] There can be no reasonable doubt that in the future it will be necessary to pay attention to a far wider field of scientific literature, produced in countries so far apart as Holland and Japan, but all serving to advance the development of an adequate financial theory.

§ 12. As noticed above (§ 8) the separation of economic theory from practical questions had a depressing effect on financial studies in English-speaking countries. There was a decided decline of interest in the scientific treatment of financial questions. McCulloch's treatise remained for a

[1] The text-book of the Hungarian writer Béla Foldes appears to be an important one.

long time the sole work of a general character. The English tax system was earliest discussed by Leone Levi (1860), Morton Peto (1863), and Wilson. A series of books by Noble criticised it from the extreme radical and free trade standpoint. More scientific treatment was shown in the *Encyclopædia Britannica* articles of Thorold Rogers ('Finance') and Professor Nicholson ('Taxation'). Special questions were well discussed by Baxter, Jevons, Leslie and Mr. Palgrave. But, speaking broadly, the question of a scientific finance was unsatisfactory.

The decided revival of economic studies, both theoretical and historical, during the last fifteen years has had its effect on finance. The first sign of improvement was the appearance of important historical works by Hall (*A History of the Customs Revenue of England*, 1885), Buxton, (*Finance and Politics*, 2 vols., 1888), and Dowell (*History of Taxation and Taxes in England*, 4 vols., 1884; 2nd ed., 1888), the last named giving an excellent account of the development of the British financial system. The difficult problems connected with local taxation have been examined by Messrs. Sargent, Moulton, and O'Meara in the interests of the several parties affected. The various aspects of local finance have been scientifically expounded by Mr. Blunden, and 'local rates' have found an inimitable historian in Mr. Cannan, while the effect of assigning imperial taxes in aid of local revenues has been investigated by Mr. Chapman. More general theoretical problems have received attention in the series of articles by Prof. Edgeworth, as also in Sidgwick's works; and within the last year the subject of finance has been comprehensively reviewed in the concluding volume of Prof. Nicholson's *Political Economy*. In periodical literature, too, financial questions have received more notice, owing probably to the greater pressure caused by the rapid growth of expenditure, which has aroused practical interest and compelled reference to general principles.

Another class of contributions has also of late years

increased in importance. England has gained a high reputation for the merits of its 'Parliamentary Papers' and 'Reports.' Some of the most valuable studies in the statistics and theory of finance are embodied in these ponderous volumes. The Report on Import Duties (1840), The Inquiries on the Income Tax (1852–3 and 1861), and the Returns on Public Income and Expenditure (1869), are good examples. But in recent years many additions of special value have been made. The Committee on Town Holdings (1886–92), The Lords' Committee on Betterment (1894), The Report on the National Debt (1891), Sir H. Fowler's Local Taxation Report (1893), and The Royal Commissions on 'Indian Expenditure' (1896–1900), 'Irish Financial Relations' (1895–6). and 'Local Taxation' (1898–1902), have supplied a mass of materials and theories of the highest interest to scientific students. The speeches of finance ministers and the debates on financial measures are buried in the volumes of Hansard and therefore difficult of access, unless, as in the case of Peel, and, partially, of Gladstone, reprinted in a separate form.[1]

§ 13. The comparative apathy respecting the study of finance which, as we have seen, existed in England was also to be found in the United States. The burning question of the tariff excepted, there was little in personal problems. Mr. Wells's Reports mark the opening of discussion after the close of the Civil war. The great development of economic science since 1888, however, soon extended to finance, and a valuable body of literature has been produced in the last ten years. Short text-books of a high character have been written by Professor Plehn (1886, 2nd ed., 1900), and Professor Daniels (1897), and a larger treatise of considerable merit by Professor H. C. Adams (*The Science of Finance*, 1898), whose work on *Public Debts* (1887) was one of the first indications of the new growth. Professor Seligman has dealt with the more

[1] Gladstone, *Financial Statements*, 1853, 1860–64; Goschen, *Local Taxation* (1872), may be referred to.

important problems in an admirable series of volumes: (*Shifting and Incidence of Taxation*, 1892, 2nd ed., 1899) (*Progressive Taxation*, 1894, *Essays on Taxation*, 1895), and in special articles. Professor Ely's *Taxation in American States and Cities*, and Professor Kinley's *Independent Treasury* are valuable studies in widely different fields. The bulky volume by D. A. Wells represents an older point of view, but is serviceable for its facts. Instructive monographs by Messrs. Rosewater (*Special Assessments*), Ross (*Sinking Funds*), West (*The Inheritance Tax*), and F. Walker (*Double Taxation*), are specimens of the literature, dealing with the theory and history of finance, which is being steadily increased. Dr. Hollander has edited a volume of *Studies in State Taxation* (1900), confined to five southern states, and has himself written the *Financial History of Baltimore* (1899). The *Essays on Colonial Finance* (1900) is a result of the expansion and imperialist policy of the United States. America, like England, is rich in official reports and statistical returns. Of considerable, though very unequal, value are the Reports of the 'State' Tax Commission. The New York Report (1871), the Ohio Report (1883), and the Massachusetts Report (1897), may be specially mentioned.[1]

[1] Sherman's *Speeches and Reports on Finance and Taxation* may be referred to as a specimen of the work of American politicians of the better kind.

BOOK I

PUBLIC EXPENDITURE

CHAPTER I

STATE ECONOMY. GENERAL CONSIDERATIONS

§ 1. THE question of the nature and amount of public outlay forms, as we have seen, one of the cardinal branches of finance; it has an important influence on the other departments of the subject, and may be regarded as the real end of the financial system. In order to estimate correctly the expenditure of any given society, for state or public purposes, it is desirable to see the general features of the agency which so applies this part of national wealth. Most persons are familiar with the conception of a state economy, and are even prepared to adopt the view prevalent among students of social science, that Society is an organism with an independent life, manifesting itself in the exercise of different functions, one set of which has been specialised in the regulating organ or the State. Without pressing this resemblance so far as is sometimes done,[1] we may accept the evident fact that the state organisation has certain points of analogy with the arrangements of the individual, and that in regard to economic action the comparison is particularly close. The individual and the State have each receipts and expenditure. Each endeavours, or should endeavour, to obtain the greatest result with the smallest effort; for each it depends on the relation between these economic categories whether wealth is being accumulated or debt incurred; and for each a careful method

[1] *E.g.* by Mr. Spencer, *Principles of Sociology*, Part ii.

of keeping accounts is needed as a safeguard against errors. There is, however, a still closer parallel to be found in the case of those associations formed for the accomplishment of certain special ends which are usually known as 'juristical' persons or corporations. From the ordinary private partnership, through the local trading company, the progression can be traced up to such a body as the East India Company, that at one time was sovereign all but in name. In all these associations the principal financial phenomena are exhibited in a similar manner, and in a way that helps to explain the character of state finance. The existence of such general resemblances should not, however, conceal from us the fact that public agencies are in some essential points distinct from the 'economy' of the individual or of the association. It is the presence of these special and peculiar features that renders the examination of state economy needful in treating of public finance.

2. The first distinctive point in the public or state economy is its compulsory character. The individual or private association has to submit to limits other than those of his or its own will, but so far as legal restraints are concerned, the State stands in a position of complete independence. It is entitled to claim all the services and property of its subjects for the accomplishment of whatever aims it prescribes to itself. When stated in so rigid a form, the proposition is likely to awaken dissent, and yet, from the strictly legal and administrative point of view, it is a commonplace since the time of Austin.[1] The effectual limits to state action depend, not on any legal or administrative rules, but on the difficulty of overcoming the obstacles set by external nature, and the sentiments of its subjects. Its expenditure and the objects to which it is directed are bounded by the productiveness of the national industries, and the facility with which the national wealth

[1] See his *Province of Jurisprudence Determined*, and for earlier statements of the same truth, Hobbes, *Leviathan*, ch. 18; Bodin, *De Republica*, Bk. i. ch. 8.

can be obtained through taxation for public use. The compulsory nature of state action is, then, a trait which marks it off from the individual or the private society.

A second point of difference appears in the ends to be attained through state agencies. They are mainly, as Roscher remarks,[1] of an immaterial kind: the protection of the society against aggression, or internal disturbance, and the promotion of progress in civilisation, are hardly capable of being definitely measured and assigned a precise value, nor, even if they were, could the share of each individual be allotted to him in the exact proportion that he was willing to pay for it. The force of the State must prescribe what is to be paid by its subjects as a body, and the share that shall be borne by each. As regards expenditure, the absence of a strict standard makes it very hard to judge the extent to which the public resources should be applied for the satisfaction of the several wants. This vagueness is made still more apparent by confining our attention to a single public need in a given country—say, the amount of protection against foreign and home enemies required by England at present. How shall we determine the expenditure that is suitable for this object? 'Adequacy in such cases,' says Sidgwick, 'cannot be defined by a sharp line. Most Englishmen are persuaded that they at present enjoy very tolerable protection of person and property against enemies within and without the country, but it would be difficult to argue that our security would not be enhanced by more and better-paid judges and policemen, or more and better-equipped soldiers and sailors.'[2] The problem, it is evident, can only allow of an approximate solution, such as the actual circumstances will permit, and this finds its expression in the sentiment of practical statesmen, who say with Sir R. Peel, 'In time of peace you must, if you mean to retrench, incur some risk.'

When the problem is widened so as to include the relations of the several wants of the public organs of the society,

[1] § 109. [2] *Political Economy*, 543–4 (1st ed).

its difficulty is increased ; the adjustment of the separate items of outlay and the proportion that the total amount shall bear to the sum of national revenue, is a task that tries the abilities of the most skilful administrator.

In connexion with the direction of public expenditure, a third feature of public economy comes into prominence ; one which, it is true, may in some degree be found in private associations, but in a very restricted form. That is the existence of special interests opposed to the general welfare. It goes without saying that the individual desires what he deems to be for his own good, and in most private companies the shareholders wish for the prosperity of the institution in which their capital is invested. There are, however, cases where the holder of a few shares may make a gain indirectly, through some action of his company, which will lower its dividends, and being so far an 'economic man,' he may vote for and advocate that course. Instances of the kind are not very common, and the power possessed by persons in the situation just described is so slight that it may be neglected. The state organisation is differently placed. 'Sinister interests' exercise a good deal of control on its actions. There are large classes whose aim is to increase, not to reduce, the public expenses. More particularly is this true of those connected with the great spending departments of the state.[1] Military and naval officers are extremely anxious to insist on the importance of increasing our land and sea forces in order to secure a better system of defence. But each fresh addition to outlay unfortunately fails to secure this result, which appears as far off as ever.[2]

Reaction against the evils produced by these tendencies has, in England at least, raised up an opposite school of extremists, who are opposed to even the outlay required

[1] 'Each public department stands prepared to give the most confident reasons why it is absolutely necessary to keep up the scale of its expenditure to the exact point at which it now is.' Parnell, *Financial Reform*, 100.

[2] The events of the closing years of the 19th century both in England and the United States abundantly illustrate this statement.

for real efficiency. The inherent difficulties of the state economy are thus intensified by conflicts of interest and sentiment which, if not peculiar to it, at all events are most prominently exhibited in its working.

A fourth point of difference between the economy of the individual and that of the State is shown in the determination of the area of work for each. The citizen will naturally adopt the most profitable employment open to him, or should it seem expedient, he will combine several different occupations. The interest of others is a very secondary consideration; his activities will depend, as to their sphere and extent, on the 'net advantages' to be gained. His investments of capital will be similarly determined. Within the customary limits of law and morality he will seek to make his advantages as great as possible. The field of state action has to be mapped out on different grounds. The fact that a particular business or part of social action could be managed by the State without economic sacrifice, does not prove that it should be handed over to public agency. It is in general a sound practical rule that 'the State should not interfere with private enterprise,' and whatever be the theoretical qualifications needed, it is plain that even its partial truth limits the operations of the public power. The existence and constant working of individual and associated 'economies' (*Privatwirthschaften*) beside and under the protection of the great compulsory economy (*Zwangwirthschaft*) of the State, is a point which should never be forgotten.

Fifthly, a private economy differs from that of the State not only in the limitation of its area of action, but in the object of its working. It seeks to obtain a profit from its operations; in the language of finance it aims at a 'surplus.' The individual or company that just makes ends meet at the close of the year[1] is not in a prosperous condition. Something more is required to give a fund for

[1] *I.e.* allowing only necessary expenses for the individual, anything above being manifestly profit.

expenses beyond the necessary minimum in the former, and for dividends in the latter case. The greater the surplus the more successful is the result deemed to be. The ideal of state economy is, on the contrary, to establish a balance between receipts and expenditure. A State that has very large surpluses is as ill-managed as one with large deficits.[1] The best practical rule is to aim at a slight excess of receipts over outlay in order to prevent the chance of a deficit.[2] The position of the State as drawing its resources from the contributions of the several private economies under its charge is the reason for this course of conduct.

The last of the points of difference usually noted is rather apparent than real; it results from the mode adopted in regulating state finance, but in fact state and private economy here fundamentally agree. The private person must, it is said, regulate his expenditure by his income; the State regulates its income by its expediture. Such is in form the common mode of determination. The individual says, 'I can spend so much': the finance Minister says, 'I have to raise so much.' On looking more carefully into the matter, we discover that a certain amount of expenditure is necessary to support individual life, and that each person must procure that amount at least under peril of death. For all classes above the lowest this minimum of expenditure rises to a higher point, and

[1] Cp. the difficulties of the United States, in the years immediately preceding 1891, with their surplus revenue.

[2] Prof. Adams argues in favour of a deficit (*Public Debts*, 78-83); but the three reasons which he gives in support of his position are derived from a one-sided view of the financial experiences of the United States referred to in the preceding note. They are wholly inapplicable to other countries. The authority of Peel and Gladstone—so great on all practical matters of finance—may be quoted in support of the rule given in the text. 'The training I received from Sir R. Peel was that the right and sound principle was to estimate Expenditure liberally, to estimate Revenue carefully, to make each year pay its own expenses, and to take care that your charge is not greater than your income.' Buxton, *Mr. Gladstone as Chancellor of the Exchequer*, 157, and cp. the whole chapter.

increased outlay is essential for the obtaining of increased income.[1] On the other side, state expenditure is not definitely fixed; it has to be determined by various considerations, one of which is the pressure that its discharge will place on the national resources. We can easily conceive the United States wisely incurring expenditure that an Indian administration would as wisely avoid.[2]

§ 3. Though the several characteristics that we have been engaged in noticing mark clearly the distinct and peculiar aspect of public economy, we have still to constantly bear in mind that the consumption of wealth for public ends is a part of the consumption of wealth in general. As a study of human wants must form the basis of the economic theory of consumption, so must an examination of the number and order of state wants be an essential part of our present inquiry.

The classification most familiar to English readers is that of J. S. Mill, who distinguishes between the 'necessary' and the 'optional' functions of Government.[3] The value of this division is, however, much impaired by his subsequent admission that no employment of state agency can ever be purely optional, as also by the further concessions made in his examination of the limits of *laissez faire*. The arrangement suggested by Roscher is more in analogy with the case of private outlay, viz., that into (1) necessary, (2) useful, and (3) superfluous or ornamental expenditure,[4] corresponding to the necessaries, decencies, and luxuries of individual consumption. It does not require much acumen to add, that the first head is unavoidable, that there is generally a presumption in favour of the second, while there is always one against the last. The formation of such general categories as the foregoing does not help to solve the real difficulties of the matter.[5]

[1] Marshall, *Principles of Economics*, i. 137-8 (3rd ed.).
[2] Roscher, § 109; Wagner, i. 9-16; Geffcken in Schönberg, 6.
[3] *Principles*, Bk. v. ch. 1, § 1. Cp. ch. 11, *passim*. [4] § 109.
[5] See Appendix to ch. 8 for a fuller discussion of this point.

The terms used to describe the groups just mentioned carry with them an already-formed judgment. By placing a particular form of expense under the heading of 'necessary' or of 'ornamental' outlay, we have pronounced an opinion on its merits or demerits. It still remains to settle—and this is by far the most troublesome part of our task—the several items to be placed under each head. In order to meet this difficulty we shall find it necessary to consider the proper functions of the State, and how far it is bound to discharge each and all of those functions under circumstances of financial pressure. One of two possible lines of inquiry may be adopted. Starting from our conception of the State, we may seek to determine the proper sphere of its action, and the amount of its justifiable outlay within that sphere, using either general reasoning or appeals to specific experience as our guide. Or we may prefer to trace the development of public tasks, and endeavour by following their direction in the past to form an estimate of their present position and probable future. It may even be expedient to combine the two courses of inquiry, using each as the corroborator or corrective of the other. Here, as often elsewhere, the historical or inductive method comes in to support and check the conclusions of deduction.

§ 4. The primitive theory of politics, if theory it can be called, accepted the omnipotence of the State as a leading principle. The legislator was to fashion the society in the mould which seemed to him best; the very idea of individual claims had no place in such a doctrine. In its passage through feudalism European Society obtained the idea of private liberty, though, owing to the imperfect state organisation of the period, the effect that might naturally be expected was not produced. The centralised monarchies which succeeded the mediæval system claimed the privilege of regulating individual action in a mode that in some respects recalled classical antiquity. The religious and political struggles of the sixteenth and seventeenth

centuries were the result of their undue activity in those domains of human life. Commerce and industry did not assert their right to freedom till a later period. State regulation of industry found its highest expression in the so-called mercantile system of the seventeenth century, and particularly in the administration of Colbert.[1] The reaction against this policy produced the first theory of state action that had an economic basis—the doctrine of *laissez faire*, or, as it was entitled by Adam Smith, 'the simple and obvious system of natural liberty.' Its rise at the particular time was the result of powerful forces. It is true of humanity that 'it learns truth a word at a time,' so that, as the problem of the sixteenth century had been religious liberty, that of the seventeenth political liberty,[2] it was reserved for the eighteenth century to assert the claims of industrial and commercial liberty. The similarity in general features of these movements is remarkable. Each was the natural reaction against exaggerated pretensions; each perhaps attached too much importance to its special object, but all have profoundly affected European society for good. In examining this earliest scientific theory of the State, it is most desirable to see exactly what its doctrines really were. The common opinion that the advocates of *laissez faire* were opposed to any state action is dissipated by a study of their writings. They lived in an age of restrictions in which the most pressing work was to get the many hindrances to effectual industrial activity removed. A body of thinkers including Quesnay, Turgot, and Du Pont de Nemours among its members can hardly be said to have been indifferent to the necessary functions of the State. The real bearing of the *laissez faire* or 'natural liberty' system can be best appreciated by a consideration of the exposition given of it by Adam Smith. In a well-known passage of the *Wealth of Nations* he has set forth the functions of the ideal State

[1] *Supra*, Intr. chap. ii. for the effect on financial theory.

[2] Strictly true only of England, and in a much less degree of France.

in a manner that leaves no room for mistake as to his views.

'According to the system of natural liberty, the Sovereign has only three duties to attend to; three duties of great importance indeed, but plain and intelligible to common understandings: first, the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty of protecting as far as possible every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and thirdly, the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expense to any individual, or small number of individuals, though it may frequently do much more than repay it to a great society.'[1]

It is only necessary to read this passage in order to see that the policy favoured by Adam Smith was not a purely negative one. The State has not merely other functions than the economic ones; where private interest is likely to prove insufficient, it has economic ones also, and those, too, of great extent and importance, as will appear when considering his more detailed discussion.

The temporary predominance in the domain of political speculation of the *laissez faire* view is a commonplace of the historians of political economy.[2] We need not repeat the account already given of the different effects produced by the Smithian doctrine on French and English thought. It will suffice to see the operation of newer tendencies, and for this purpose we may pass at once to J. S. Mill. His theory of state action is, in fact, a product, or rather application, of his utilitarianism, and thus we are led to expect what we do in fact find, viz., a close resemblance between

[1] *Wealth of Nations*, 286. [2] Ingram, *History of Pol. Econ.* ch. 5.

his practical proposals and those of Bentham.[1] He declares emphatically that—

'The admitted functions of government embrace a much wider field than can easily be included within the ring-fence of any restrictive definition, and that it is hardly possible to find any ground of justification common to them all except the comprehensive one of general expediency.'[2]

This extremely vague and general statement is, however, supplemented by a declaration in favour of *laissez faire* as a general rule. 'Letting alone, in short, should be the general practice: every departure from it, unless required by some great good, is a certain evil.'[3]

In regard to state action, as in so many other respects, Mill occupied a transitional position. He had accepted the traditional creed of the economists which was strengthened by his own sympathies in favour of freedom, as well as by his study of the brilliant work of Dunoyer,[4] which he frequently quotes with approbation. But other influences affected him: the writings of the French socialists and the social philosophy of Comte both tended to impress him with the advantages of state action in certain comparatively untried directions, and consequently his attitude as to the true policy of the State is in some respects not defined with sufficient precision.

Since his time, the disposition to criticise the shortcomings of the doctrines of the Physiocrats and Adam Smith has become general. The possible theoretical difficulties and the conflicts of individual with general interest have been most forcibly stated in Sidgwick's minute and thorough discussions.[5] This natural tendency has been reinforced by the influence of German economists

[1] See specially the latter's *Theory of Legislation* ('Principles of the Civil Code').

[2] *Principles*, Bk. v. ch. 1, § 2.

[3] *Principles*, Bk. v. ch. 11, § 7.

[4] *Liberté du Travail.*

[5] *Principles of Political Economy*, Bk. iii. ch. 2. *Elements of Politics*, ch. 10.

who repudiate the practical position of Adam Smith as a product of the 'shallow *a priori* rationalism' of the eighteenth century, which regarded the State as an agent for determining private rights and duties (*Rechtsstaat*) in opposition to the older system of paternal government (*Polizeistaat*). This newer and wider conception of the State's sphere is conveyed in the term 'civilising State' (*Culturstaat*), or in the fuller description of Bluntschli, who regards 'the proper and direct end of the State as the development of the national capacities, the perfecting of the national life, and finally its completion.'[1]

Admitting the force of some of the criticisms that have been urged against an exaggerated policy of *laissez faire*, it seems nevertheless possible to adhere to the substantial truth of the doctrine quoted above from the *Wealth of Nations*. The real ground for limitation of state functions is not the existence of an abstract rule forbidding various classes of acts. The rule itself is dependent on the results of experience. To the plea that in many cases state intervention would obviate evils to be found under a system of liberty, Adam Smith would reply that the legislator's 'deliberations ought to be governed by general principles, that he must act by rules which in the supposed cases would do more harm than good, and that it is the balance of advantage which needs to be regarded.

This consideration duly weighed suggests the possibility of so modifying the older position as to include a class of cases that has appeared to be the greatest stumbling-block in its way, viz. the functions of the State in the lower stages of social development. Now it is beyond question plain that the province, and therefore the expenditure, of the regulating organs of society will vary at different stages of social progress. We may take it as indisputable that the duties of the Sovereign of a central African State and of the government of a European society

[1] *Theory of the State* (Eng. Trans. 2nd. ed.), 320–1. Cp. also Wagner, i. 76, Cohn, §§ 34 sq.

are and must be very different, but the conclusion does not follow that there are no general principles to which the modes of state action may conveniently conform. The construction of a 'cut and dried' formula for the duties of the State is perhaps an impossible task, but a careful study of the nature and forms of state activity, as determined by the character of its organisation, will help to elucidate the difficult problem of its suitable duties.

§ 5. For understanding the true position of the State it is essential to see the way in which its functions have been gradually evolved. In the rudest forms of society each individual depends on his own resources. The Fuegians *e.g.*, have no conception of government, and consequently, as Darwin notes,[1] no chance of attaining to civilisation. In the hunting tribe, where the first advance beyond the lowest stage of savagery has been made, the elder is leader in war and judge in peace, the 'warriors' are soldiers and administrators. The tribe hunts in common over its territory, which it tries to protect from intruders, and it divides the game that is captured among its members. Thus we see that war, justice, or rather the administration of custom, and economic effort are the three forms of the rudimentary society's activity. The two former, and especially war, are, however, the kind of action in which regulation is chiefly needed, and where the power of the chief is particularly manifested.

The domestication of animals, which is the characteristic of the pastoral stage, facilitates the further differentiation of the chief and ruling body. The accumulation of the peculiar wealth of the period is more an individual concern, but war and justice are public duties. Here, and even in the preceding stage, we can notice the primitive forms of public expenditure, viz., the services of the members of the clan, and commodities, in the form of weapons and supplies for those going on expeditions.

When the tribe settles down on the land and devotes

[1] *Voyage of the "Beagle,"* 229-230.

itself to agriculture, a further division of duties appears. The primitive agricultural community frequently tills its land by means of slaves; the freeman confining himself to warlike pursuits and to the duty of attendance at the public assembly, where he has to decide disputes and regulate matters of general interest.

Far later in historical order, but still presenting many points of resemblance, so far as public functions are concerned, comes the 'feudal' organisation. Some of the actuating sentiments are different, and the traditions of the Empire and the Church exercise a potent effect; but the same economic basis brings about a reversion to the phenomena of earlier periods. The feudal society is essentially militant. State power is vested in the 'King' or 'Lord,' who represents and personifies the community. In this capacity he contracts with the vassals for the supply of his (*i.e.* the State's) needs. The feudal army with its loose organisation is one result of this arrangement. Justice is administered through the Lord's Courts. The economic side of state activities appears in the management of the domain and the regulation of commerce. In this particular historical form we notice the rudiments of much that is important in the developed financial systems of the present time

The City State as it is found in ancient Greece and Italy, or in Germany and Italy during the mediæval period, presents a distinctly higher type of political life. There is no longer the tribe struggling dimly to attain to the conception of political unity. The disorganisation and absence of the idea of political, as opposed to personal, duty which mark the 'feudal' epoch have disappeared. The free citizen of Athens or Florence had as firm a grasp of the truth that he owed duties to his city as the Englishman of to-day. An exaggerated conception of the State's powers, and a disregard of private rights, were the natural consequence, but so far as the financial aspect of political life is concerned, we may note the close analogy in many respects to the modern State. More especially is this

true of the objects of public outlay. The maintenance of military (and in some cases of naval) force, the administration of justice and police, the furtherance of certain economic ends, are the principal claims on the public resources. Subordinate to these main parts of public service may be enumerated certain requirements, also represented in modern budgets—to wit, provision for religious service, for education, and for matters affecting social well-being.

Later developments of state life, either in the Roman Empire or in modern European countries, present the same general groups of public wants. Many special points will require attention when we come to examine more closely the detailed heads of expenditure, but so far as the general outline goes there is in many respects a consensus of practice in all stages of society respecting the sphere of the State.[1]

§ 6. The preceding survey of the actual development of state functions, brief and imperfect as it is, tends to confirm, and yet in some degree to qualify, the conclusions of theory. The forms of state outlay have arisen gradually in the course of history as the outcome of social conditions and sentiments, and they in turn influence the society. A community in which some special duty has been for a long period entrusted to the public power will not easily be able to dispense with this mode of supplying its need. The force of habit is here considerable. The conditions of social life are, however, subject to incessant change. The state outlay suited for the Middle Ages, when war and religion were the great operating forces, is almost necessarily unfit for the modern age, concerned as well with industry and commerce. The ready acceptance of this truth must not lead us to ignore the equally important fact, that state wants in their main features are permanent to a surprising degree. It is not in the character of the

[1] Cp. Cohn, Book i. chaps. 1, 2, for a general view of the financial aspects of social development. Also Vocke, *Abgaben*, &c. Part i.

public needs, but in the modes of supplying them, that the most remarkable changes occur. There is, moreover, a universal recognition of the superior claims of defence and justice as being the primary duties of the State.

Writers of all schools agree in this belief, and so far history and analysis are in accord. The disputable part of state outlay is that which more especially concerns economic and social administration, and even here a good deal of the matter of controversy lies outside the subject of pure finance, and belongs more fitly to economic policy. Some trifling amount may be expended on, say, the promotion of art. The advocate of *laissez faire* may object to the course as a matter of economic policy, but so far as finance is concerned the smallness of the amount makes it a matter of comparative indifference. The question of public expenditure in its fiscal aspects is best considered in relation to each particular period of society. We may even accept the doctrine of Mill, that 'in the particular circumstances of a given age or nation, there is scarcely anything really important to the general interest, which it may not be desirable, or even necessary, that the government should take upon itself,'[1] while we at the same time remember that Adam Smith's determination of the Sovereign's duties can include these possible cases. Financial theory in its application to the modern state is at all events bound to recognise and indicate clearly the difficulties which extension of state action is likely to produce. The growing budgets of all modern societies have the tendency towards enlarging the sphere of the State as their ultimate cause, and it is important to see that persistence in this policy is certain to lead to embarrassments in financial administration; but the very necessity for discussing this subject compels us to examine the forms of expenditure as they have been, and are, while seeking to indicate what they ought to be.

§ 7. Another aspect of the problem of state wants

[1] *Principles*, Bk. v. ch. 11, § 16.

requires some consideration. All economic life depends on a due supply of two distinct classes of objects, viz., commodities and services, or, in less technical language, material objects and human labour. The public power cannot dispense with either of these forms of supply, and at each period of its existence we find it demanding them both. The hunting tribe requires its warriors and their weapons and food ; either the men without equipment, or the outfit without the men, would be useless. This distinction runs through every phase of social evolution, though it is much more complex in the higher stages. A very rude community can summon its members to act for the public good, and require them to fit themselves for their task. In such cases outlay and income are combined ; the member of the tribe is at once paying his taxes and performing a public service. The opposite extreme is witnessed in a civilised State of the present age. The supply of public wants is obtained by the purchase of commodities and the hire of services, the power to carry out these transactions being procured through the possession of the public revenue. Intermediate stages show us the way in which personal service was commuted for money payment, and the delivery of commodities in kind was obviated by the development of a money economy. Survivals of the older order continue ; in some cases they are too important to be regarded as mere relics of the past : they are rather 'revivals' under new and favouring conditions. When dealing with revenue we shall have to compare the direct with the circuitous method of supplying public needs, and in the present Book we shall have to note some of the economic consequences of the adoption of one or other of these modes.

Having disposed of the more general aspects of public expenditure, we shall next consider the several details, commencing with the oldest and most enduring—the need for defence against outside enemies.

CHAPTER II

THE COST OF DEFENCE

§ 1. ADAM SMITH commences his examination of the cost of defence by the statement that 'it is very different in the different states of society,' and adds, as the result of his inquiry, that it 'grows gradually more and more expensive as the society advances in civilisation.'[1] A reference to the statistics of military and naval expenditure will show that the tendency to increased outlay has continued during the century that has elapsed since the above passage was written.[2] There is, moreover, no sign of change in this respect. It is as certain as any prediction in social matters can be, that no reduction in the military budgets of Europe will soon be made; on the contrary, there is every probability that this form of expenditure will go on increasing in the future as it has done in the past.[3]

The causes that have produced this, at first sight, unfortunate state of things must, it is clear, be deep-seated and persistent, and accordingly, when we scrutinise more closely the operating forces, it appears that the increased cost of warfare, and of the preparations which it involves, is closely connected with some of the normal features of social development. It is principally the result of two general tendencies, viz. (1) the increased division of labour which necessarily accompanies the advance of society, and (2) the

[1] *Wealth of Nations*, 289, cp. 296.

[2] See tables at end of this chapter.

[3] This statement is amply confirmed by the growth of expenditure in the past ten years. But cf. the view of Adams, *Finance*, 56–7.

development of those inventions that are such a striking characteristic of modern civilisation. The former makes it absolutely essential to set a specially trained section of the population apart for military service, to the sacrifice of their assistance in the ordinary work of production, while they usually receive a higher reward than a similar body of labourers would be able to command in the market. The pay of the British Army is a good illustration of this fact, and it is the most suitable instance to take, as enlistment in it is purely voluntary. The rapid progress of scientific discovery increases the cost of warlike material and equipment, since the constituents of this part of 'consumers' capital,' as it may be called, become much more elaborate and have to be more frequently replaced. If we compare the stock of weapons of a savage tribe with the equipment of a mediæval army, and either of them with the war material now necessary for a single 'army corps' of any European State, we cannot fail to recognise the increase in complexity and in cost which the later organisations show. Even in the last quarter of a century the changes in warlike implements and supplies have been such as, while vastly increasing their cost, to render them very different from the appliances previously existing.

§ 2. The expenses of defence and aggression have, it must be noticed, to be divided into two distinct parts. The former, which may be regarded as the normal and regular part—the peace establishment—meets the preparation for war. It is so well recognised a feature of the modern budget, that it passes without comment. The other part of state outlay in this respect is that devoted to actual warfare; it is evidently irregular in amount, and may so far be called 'abnormal,' though it is almost certain to recur at indefinite intervals.[1]

The cost of preparation for war consists in obtaining a supply both of services and commodities, *i.e.* in the recruiting and training of troops, the provision for pensions,

[1] See *infra*, Bk. i. ch. 8, § 1. Cp. Wagner, i. 417, sq. Roscher, § 119.

and the selection and preparation of arms, ammunition, and stores generally. Actual war causes expenditure on campaigns and expeditions, and, further, in the replacement of losses, alike in men and stores, incurred during its continuance. In estimating the loss to society through the persistence of the custom of war between nations, both the above-mentioned elements have to be combined in order to judge accurately of the real cost imposed.

§ 3. Preparation for war, as it appears in the successive stages of society, conforms to the general principle declared by Adam Smith. In a savage or barbarous community the cost of warlike preparation is insignificant. The ordinary course of life is of itself a training for times of conflict; the hunter or shepherd is ready at the shortest notice to transfer his exertions to a fresh and more exciting employment. Such rude societies are (with some rare exceptions) organised on a basis of militancy, all the adult males being available as warriors. Similar conditions prevail with respect to commodities. Bows, spears, staves, &c., are useful either in peace or war; they are eminently non-specialised capital, and more elaborate contrivances are as yet unthought of. The introduction of agriculture has a modifying effect, in so far as it tends to reduce the mobility of labour and commodities; but even in this stage the same general features recur. The ordinary husbandman easily becomes a soldier, and there is a recognised interchange between swords and ploughshares. An invasion is still carried out or opposed by a *levée en masse*, and usually takes place in the 'off season' of agricultural work. The cost of preparation for such wars obviously cannot be very heavy.

The introduction of manufactures, and the establishment of urban life that accompanies it, put an effectual check to the ruder forms of belligerency. A State possessing the varied elements of an industrial society—even in a rudimentary form—cannot permit the suspension of the normal economic processes during a period of hostilities, and it is

therefore compelled to make adequate arrangements in time of peace in order to obviate the danger. The difficulty is met by the introduction of standing armies, whose origin is thus easily explained. It, in fact, becomes necessary to carry the gradually increasing division of employments into the military art, and to form at least the nucleus of an army, which can be readily increased in case of need. The difficulty of suddenly shifting the artisan from the workshop to the field of battle makes this imperative. Improvements in weapons and systems of discipline furnish additional reasons in favour of increased special training, to be given either to the whole efficient population, or to a selected portion of it, but in any case involving larger outlay.

In the section of the *Wealth of Nations* devoted to this topic the adoption of either of the alternatives just mentioned is regarded as a cardinal point in the evolution of the military system. The former method—that of training the whole effective population—is described as the creation of a militia, the latter as the formation of a standing army, and a very strong judgment is pronounced in favour of the latter expedient. Admitting fully the truth of some of the views set forth on this point by Adam Smith, it is nevertheless desirable to remember that they by no means exhaust the subject and the considerations relevant to it. His appeal to history more particularly strikes the reader as superficial. To support his contention that standing armies are always superior to militias—an idea evidently derived from his belief in the advantages of increased division of labour[1]—he brings forward the examples of the Macedonian army that overthrew the forces of the Hellenic commonwealths and the Persian Empire; the early successes of Hannibal and the ultimate triumph of the Romans; and finally the fall of the Western Empire before the barbarian invaders. The cases quoted, however,

[1] In some cases Adam Smith saw clearly enough that division of labour was not always desirable Cp. *Wealth of Nations*, 217 with 327.

fail to establish the doctrine asserted. It is surely contrary to fact to speak of the army of imperial Rome as a 'militia'; if ever there were a 'standing army' it was one. The whole discussion, in short, amounts simply to this: that the better disciplined and trained force will generally defeat its opponents, and that it ought to be called a 'standing army.' The historical summary is accurate, if somewhat trite, but the interpretation results in a truism.

We have therefore to replace Adam Smith's account by one more consonant with facts, while preserving those parts of his exposition that are substantially correct. It is certainly beyond dispute that the course of development tends to replace the rude levies described as 'militias' by the better trained forces known as 'standing armies.' In addition to the instances given above, we may mention the introduction of permanent armies in every European State, so that the tendency towards specialisation is very generally operative. An opposing tendency, however, comes into play. It is equally a principle of evolution that all organised bodies tend to lose their original plasticity; they become, as it were, crystallised into a rigid form, and from this condition armies are not exempted. But warfare is the struggle for existence in its intensest shape, and in that struggle, mobility and power of adjustment are important advantages. The natural result is that the most efficient military machine or organisation of one period proves to be unsuitable for the changed requirements of another and later one. The history of war is, in fact, a series of illustrations of this truth. As convincing and well-known examples we need only note the Phalanx, the Legion, the man-at-arms of mediæval times, the army system of Frederick the Great, and the French system of the 19th century. And it may well happen that a future European war will afford a further instance in the fate of the present German army. The essential condition of military efficiency is constant readjustment—incessant striving towards improvement in discipline, training and equip-

ment. Such efforts, necessary as they are, demand continuous intellectual strain on the part of the organisers, and heavy demands on the public purse.

§ 4. If, as we believe, Adam Smith failed to correctly interpret the past, he certainly did not succeed in forecasting the future. Up to his time there had been a steady movement towards the establishment and increase of permanent forces maintained at great cost. The effect produced on thoughtful persons by the growing European armaments is instructively shown in the statement of Montesquieu. A remarkable chapter of the *Spirit of Laws* [1] describes the position and its dangers to the future of Europe in the following terms:—

'A new disease has spread through Europe; it has seized on our sovereigns and makes them maintain an inordinate number of troops. It is intensified, and of necessity becomes infectious, for as soon as one State increases its forces the others at once increase theirs, so that nothing is gained by it except general ruin. Each monarch keeps on foot as many armies as if his people were in danger of extermination; and this struggle of all against all is called peace! Thus Europe is ruined to such a degree that private persons, in the present position of the three richest Powers of that quarter of the globe, would not have the means of living. We are poor with the wealth and commerce of the whole world; and soon, by dint of having soldiers, we shall have nothing but soldiers, and be like the Tartars. For that we need only make effective the new invention of militias established in most of Europe, and carry it to the same excess as we have the regular troops.'

This vigorous account has been largely justified by the actual course of events. The wars that resulted from the French Revolution proved the power of national sentiment to raise and maintain enormous forces during a period of protracted conflict, and the reform of the Prussian army under Scharnhorst's guidance, after the disaster at Jena,

[1] Bk. xiii. ch. 17.

carried the tendency towards the enrolment of the nation into periods of peace. The wars of the third quarter of the 19th century, and especially the Austro-Prussian war of 1866, and the Franco-German one of 1870–1, have greatly increased the popularity of the national army system, which has been adopted by nearly all Continental States,[1] and has been approved by many English writers. The change of opinion in recent years is perhaps most clearly shown in a remarkable essay of Cairnes, in which the respective merits of the older French, the English, and Prussian systems are estimated, with a conclusion strongly in favour of the 'national army.'[2]

We may seem, for the moment, to have lost sight of economic and financial considerations, but they really underlie the whole military movement of modern times. The increase of permanent forces had reached its limit before the opening of the French Revolution, when about one per cent. of the population was available for actual service. The prolonged conflicts which arose out of that event led to the addition (as Montesquieu apprehended) of a militia to the regular forces. The modern national army in its full force is the old 'standing army,' plus a *levée en masse*, the latter, it is true, being suitably organised and equipped. This system, though produced at first by a particular set of circumstances, was obviously necessitated by economic conditions. Military power had to be increased, and as the state revenues did not allow of an enlarged permanent force, the only alternative was that actually adopted, by which the whole effective male population became a reserve, and was yet enabled, in times of peace, to carry on its ordinary industrial pursuits.

The question of cost is in the last resort decisive, and it is by it that the merits of the several military systems must

[1] See Wagner, i. 427, for a full list.

[2] Cairnes, *Political Essays*, 199-255. On this point his judgment is for once supported by the agreement of Cliffe Leslie [*Essays* (1st ed.), 128–147], whose opinion is the more valuable, as it was formed after personal study of the Prussian system, and was in opposition to his earlier belief.

be judged. One of the conditions to be included in our measurement of net cost is efficiency. National defence is too important, even from a purely economic standpoint, to be placed in jeopardy through narrow ideas of economy. An ineffective and badly organised army is dear on any terms, though, on the other hand, large outlay will not of itself secure efficiency, and so far weakens the economic resources of the nation. The problem is, indeed, as remarked before,[1] one of extreme difficulty, and only allows of an approximate solution. As regards the cost or sacrifice involved in the various methods of defence, the national army presents two great advantages: (1) it requires less direct outlay, and (2) its real pressure is not so acutely felt. It is plain that services obtained through legal compulsion will be cheaper than those that are hired in the labour market at the current rate. Moreover, when the duty of military service is general, and enforced without favouritism, the sacrifice entailed by it will probably be less felt than if the large amount of additional funds needed under voluntary enlistment had to be levied through taxation. Granting, however, both these positions, it yet remains doubtful whether the indirect losses may not be more than the gains just mentioned. The real cost of an army formed on the German type is hard to measure. Mere comparison of army estimates will not establish its superiority over a freely enrolled force. Thus an able writer[2] compares the English and German outlay for 1883–4. The former was £16,600,000 for 199,273 men, the latter £18,325,000 for 445,392 men, *i.e.* an army much more than twice that of England was maintained by Germany at an increased cost of only 10 per cent. This estimate is supported by additional calculations, which make the cost per soldier in England £86, in Germany only £44, or little over half. Such calculations err in the omission of several material circumstances. The rates of wages and salaries in the two countries are not on the same level. Under any system a

[1] *Supra*, ch. i. § 2.

[2] Geffcken in Schönberg, 53.

given number of German soldiers would cost less than an equal number of English ones. Next, though the compulsory service in the former country reduces considerably the amount of direct outlay by the State, it inflicts a tax on those compelled to serve, whose amount could be measured only by what they would pay in order to escape it. A third influencing condition is the indirect effect on the productive powers of the country.

'The military service,' says a favourable critic of the German army, 'postpones to a relatively very late period the productive use of the productive power of the country . . . The waste of skilled labour . . . is enormous. The future artisan or mechanic has not learned his business when he enters the army, nor can he practise it until he leaves the regiment. . . . Half the lifetime of the flower of the population is thus unproductively spent. Even in the case of unskilled labourers or peasants, who can go to work from the day they leave barracks, a considerable loss is sustained.'[1]

None of the foregoing considerations are taken into account by Geffcken. It may, indeed, be argued that the habits of discipline and order acquired during service should be placed to the credit of the German system, but this questionable item would not much affect the general result, more especially when we add the probable loss of originality and initiative, which is another result of discipline. The national army system further involves a supervision of the movements of all the members of the potential war force, and such regulation must in some degree restrict the free flow of labour to suitable markets.

The difficulties in the way of any estimate of the financial merits of different army systems, already evident enough, are enhanced by the special circumstances with which each country has to deal, and which render the complete adoption of a foreign system almost impossible. Thus England has

[1] Leslie, *Essays* (1st ed.), 143. See Wagner, i. 426, for a directly opposite view.

to provide garrisons for many places very distant from her own territory, and service of this kind in India or the Crown Colonies could not be made compulsory. Separation of the home and foreign (or Indian and Colonial) armies appears a retrograde step,[1] and in any case the supposed home force might, in time of pressure, be required for service abroad. A great power whose foreign possessions are insignificant has not this problem to face.

§ 5. A partial solution of the difficulty of procuring sufficient military force without compulsory service, and at the same time keeping expenditure within due bounds, is presented in the English Volunteer system. By this method the public spirit of the citizens leads them to give a portion of their time to acquiring the rudiments of military training and sufficient dexterity in the use of weapons. Competent military opinion seems, however, to hold that a considerable degree of organisation is necessary in order to make volunteer forces of any real service in time of war. The endeavour to combine the strict discipline essential for the soldier with the freedom naturally claimed by the volunteer is not an easy one, though the object is eminently desirable. Besides its great advantage in fostering the national sentiment of the members, and impressing them with the conception of their duties to the State, the volunteer corps would, by taking charge of the home fortresses, probably allow the regular troops to be drawn off for foreign service, and would also be a valuable source for recruiting.

It may further be remarked that a very general enrolment of the active population in such bodies, under proper discipline, would be equivalent to the national army system and at the same time avoid the evil of compulsion. In this as in other cases of volunteer assistance for public service, the chief difficulty is to enable the two agencies to fit into each other without friction or waste.

§ 6. The navies of the various powers do not present so

[1] This plan has been advocated by Sir C. Dilke, *Problems of Greater Britain*, 380.

much difficulty, for they are less costly so far as the supply of their personal service is concerned, and that supply is taken from a special class already trained to a life of hardship, and accustomed to constant supervision and control, though here, too, the question of obtaining the necessary force without undue outlay is a serious one.[1]

§ 7. The best and most economical mode of supplying equipment and material for both military and naval forces has been for some time recognised as a grave problem. The extraordinary rapidity of inventions soon makes the most costly and best devised appliances antiquated. It seems a hopeless task to provide all new agencies of attack and defence, owing to their great expense and their certain replacement by later improvements, so that it might appear that the wisest course was to await the outbreak of war, and then procure the best existing weapons. Unfortunately such a course is not practicable. Ships and ordnance cannot be speedily produced and distributed. The stock, the 'fixed capital' of destruction as it may be called, like that of productive industry, takes time to create, and in warfare delay is fatal. A steadily progressive policy seems the most advisable in this respect, even from the purely financial point of view, as the pressure is more evenly distributed,

[1] Though naval expenditure is usually much less than that required for military purposes, yet the English naval estimates for each of the five years, 1895–1900, exceeded those for the army, as the subjoined table shows. This was of course due to the peculiar situation of the British Empire, with its territories spread over the various regions of the globe. The South African War has for the time removed this anomaly, but the return of peace may recreate it.

Year.	*Army Estimates.*	*Navy Estimates.*
1895–6	£17,983,800	£18,701,000
1896–7	18,042,100	21,823,000
1897–8	18,340,500	22,238,000
1898–9	19,220,500	23,778,400
1899–1900	20,617,200	26,594,500
1900–1	88,999,400	28,791,900
1901–2	87,915,000	30,875,500
1902–3	69,310,000	31,255,500

and by adopting it there is, on the whole, the best chance of security.

Against the undoubted evil of the great increase of outlay on armaments, it is satisfactory to be able to point to some compensation, or at least alleviation. One result is to favour the wealthier, and therefore the most industrious nations. A rich State can obtain the best ships, rifles, and cannon, and so gains the same advantage over its poorer rivals that civilised peoples generally gained over barbarians by the invention of firearms. Then, as Sir R. Giffen has suggested, the increased cost of warlike equipment is accompanied by an immense expansion of industrial production; if the burden be heavier the bearer is stronger, and is not so much oppressed as we might at first suppose; and finally, though this is problematical, the skill developed in aiding the work of destruction is also of service for industry.[1] The best method of securing arms and supplies is also a doubtful matter. The usual alternatives are: purchase in the open market, or state manufacture; and in the former case the contracts may be given privately, or by public tender; but the advisability of state manufacture may be reserved for a more suitable place.[2]

§ 8. The cost of actual warfare presents problems very similar to those already considered. The national army, when in the field, is a very expensive agency. 'An army composed of such materials as the Prussian, cannot be employed in war without immense loss and suffering both to the soldiers and the whole nation.'[3] The ordinary standing

[1] Giffen, *Growth of Capital*, 145. Cp. 'Wie die produktive Technik des Jahrhunderts ihre Kehrseite hat in der Technik der Zerstörung, so wird die erstere tributär gemacht für die letztere, und je ergiebiger sie ist um so mehr muss sie abgeben . . . . . Die hiermit gebotene Aussicht ist nicht erfreulich; sie ist aber auch nicht so trostlos, wie sie meist dargestellt wird,—unter der Voraussetzung nicht, das bei jeder betheiligten Nation der Fortschritt des Militärausgaben von der fortschreitenden Productivität der Volkswirthschaft begleitet ist wie bisher.' Cohn, § 390. For the supposed stimulus to industry, see Sir F. Abel's presidential address to the British Association at Leeds, *Report* (1890), 25.

[2] Bk. ii. ch. 3, 'The Industrial Domain.'

[3] Leslie, 140, who adds some striking instances.

army, on the other hand, is often unfavourably criticised as being composed of the refuse of the population.[1] Were this true it would be rather an advantage in the event of war, except in so far as it detracted from military efficiency. In any case it is difficult to measure the cost incurred in war apart from the direct outlay and the loss of men and material in the conflict. There is, besides, the disturbance in the economic system which is a necessary result, and which may injuriously affect, not merely the national well-being, but the state revenues. Such consequences are hard to foresee, and vary widely in different nations. With regard to England, for example, the outbreak of war would materially injure her shipping trade, which forms so important a part of her industry; the diminished profits in that trade, and the innumerable dependent and connected occupations, would soon be shown in the reduced income-tax returns under Schedule D and would so far affect the state receipts at a time of extra pressure. It is needless to add that the revenue would almost certainly be acted on by other results of war, and not beneficially. A Continental State would probably suffer in a different way. Some of its territory might be occupied by the enemy, and its contributions suspended, or under the most favourable circumstances the productive powers of the community would be reduced by the withdrawal of so many men from their usual employments with the natural result of diminishing the yield from taxation.[2] All such elements form part of the financial considerations appropriate to the subject.

To make the estimate a fair one, it is further desirable to take into account the possible advantages so forcibly stated by Wagner[3] and others. They are: the ennobling effect of warfare on men, and even its value as an economic discipline; its tendency to bring about a better grouping of nations (as in the recent cases of Germany and Italy); and finally the fact that successful warfare may allow of the cost being placed on the vanquished. It might be

[1] Cairnes, *ut sup.* 223. [2] Leslie, 141. [3] i. 416 sq.

added that some periods of war have been seasons of high profits, as was the case in England during the French wars of 1793–1815. But these supposed gains are, after all, no adequate set-off against the certain losses. There is no evidence that war promotes higher social or economic training, and it decidedly deadens the higher moral feelings.[1] Under given conditions, capitalists may gain by it, but only at the expense of other classes. The power of placing all the expense on the conquered party is not a diminution but simply a shifting of the burden, as happened in the Franco-German war of 1870–1.[2] And the redistribution is not always purely beneficial to the winning side, while it intensifies the sufferings of the defeated State.

§ 9. In conclusion, it may be said that war and preparation for war are by far the heaviest charges on the resources of modern States.[3] An enormous sacrifice of labour-power and of commodities is inevitably caused by its persistence as a usage among modern nations. The uncertainty and indefiniteness of the requirements of states for this end is a perturbing element in financial arrangements. War has been the principal cause of the great state indebtedness so general in Europe, and of the severe pressure of taxation. It is consequently beyond reasonable doubt that peaceful methods of settling disputes, or limitations on the present rigour of belligerent rights,[4] are not merely social, moral, or even economic reforms : they are further of the greatest financial importance. Arrangements for disarmament, if possible, would belong to the same class. But while strongly insisting on the great advantages that are certain to result from the maintenance of peace, and the reduction of military and

[1] For an admirable statement of the evils of war see the essay on 'The Evolution of Peace,' in Lawrence, *Essays on Modern International Law*, 234 sq.

[2] Giffen, *Essays in Finance* (1st Series), 1–55, gives an estimate of the cost of that war.

[3] See Note at end of Chapter.

[4] The exemption of private property at sea from capture is the most obvious and desirable reform in this direction.

naval expenditure, it is quite as essential to assert that so long as present conditions last, a well-organised and effective system of defence is a necessary part of state expenditure, and one that amply repays its cost by the security that it affords for the political independence as well as the economic interests of the nation. To maintain a due balance between the excessive demands of alarmists and military officials, and the undue reductions in outlay sought by the advocates of economy, is one of the difficult tasks of the statesman. In endeavouring to attain the proper mean, many specially financial considerations have to be noticed. Among these are: the relation of state to national revenues; the risks to which unsuccessful war would expose the country; and the comparative urgency of the other claims on the State. The application of the amount judged necessary is also difficult to determine. It has to be distributed between services (*Personalbedarf*) and commodities (*Realbedarf*), so as to secure the maximum advantage, but this latter question lies, strictly speaking, outside the limits of finance, and belongs to military administration.

NOTE

The growth of expenditure for military and naval purposes is very plainly shown in the following table (000's omitted):—

TABLE I

Expenditure of England and France on Army and Navy at different periods.

ENGLAND.[1]		FRANCE.	
Year.	*Amount.*	*Year.*	*Amount.*
1775	£3,810	1774	£4,880
1823	14,350	1830	12,960
1847	18,500	1847	19,320
1857–8	23,500	1858	19,960
1868–9	26,891	1868	26,320
1878–9	30,252	1878	29,240
1889–90	32,781	1890	37,640
1893–4	33,566	1900	38,880
1895–6	37,407	1902	41,151
1900–1 (war)	121,230		

[1] Besides home expenditure the military force of the British Empire costs India about 230,000,000 rupees, or £15,333,000.

TABLE II

Military and Naval expenditure of—

(*a*) THE GERMAN EMPIRE.

Year.	*Amount.*
1873	£19,200
1876	21,900
1883 4	22,750
1888–9	41,900
1900–1	39,090
1902–3	39,946

(*b*) ITALY.

Year.	*Amount.*
1862	£8,500
1869	6,800
1875	8,760
1880	10,120
1886	13,120
1890	14,500
1900–1	15,377

TABLE III

Total Military and Naval Expenditure of the Six Great Powers.[1]

Year.	*Amount.*
1868	£104,250
1873	124,450
1882	146,460
1888	180,200
1900[2]	275,000

Whatever qualification may be requisite in consequence of the above figures being obtained from different sources cannot affect the general conclusion that they are adduced to support—the increase of expenditure for the purposes of defence and aggression.

[1] Austria, England, France, Germany, Italy, and Russia.

[2] Probably £70,000,000 should be deducted for the abnormal outlay by England in South Africa, but this expenditure is likely to continue in part for some time.

CHAPTER III

JUSTICE AND SECURITY

§ 1. In tracing the gradual development of state functions, we found that the maintenance of internal security, the protection of each member of the society against 'the injustice or oppression of every other member of it,' or in more modern phrase the establishment of law and order, was a task that was attempted in the earlier stages of social evolution, and one that became more fully emphasised as political institutions grew in strength. The necessity of the function is admitted by all except advanced anarchists. In fact, the extreme urgency of the claim for public activity in this respect has frequently led to a comparative neglect of other sides of state duty. Both in its social and economic results the establishment of security is of the utmost importance; but there is the danger of limiting its range too narrowly. All institutions and legislative measures that tend to increase the power and resources of the State so far conduce to the preservation of order, and this wider point of view should never be ignored, though it is necessary to give the most prominent place to the agencies directly employed in promoting the end.

An instance of the disposition to unduly confine the subject is found in the *Wealth of Nations*. The section of the work devoted to this topic deals solely with the administration of justice. Adam Smith appears to have believed that the one matter of importance for the State was to decide disputes, though his account of the introduction

of law courts shows that it is just as essential to suppress disorder. The sovereign does certainly discharge a most useful function in settling controversies about the precise nature of private rights and duties: but beside the claims of individuals, there is the whole body of public law, and even individual rights have to be determined in respect to their orbit and incidence by the State. The ultimate aim is the promotion of social welfare by the establishment of security, which may be obtained in two different ways, with very dissimilar financial effects. 'The Legislature may pass laws which give certain rights and remedies to the persons interested, and may leave it to them to enforce the law by taking their own proceedings, according to their own interests, in the courts of law. In this case the courts are the organs through which the State exercises its power. Or, again, the Legislature may entrust the duty of enforcing the law to an executive department, which then becomes the organ of the State for the purpose.'[1] The former method would come under the head of 'justice'; the latter under that of 'police' or 'administration,' and it is a significant fact that it is not noticed by Adam Smith. His whole economic system, on its practical side (in this respect in strict agreement with the Physiocratic position), was a protest against the older paternal policy. He had no conception of the development of administration and supervision for social and even economic ends, which is so characteristic of the modern State, and consequently his work presents a gap in regard to this important subject.

The student of modern finance is, however, compelled to take the different elements of justice and administrative police into account when seeking to estimate the cost incurred in guarding the rights of private persons, and the security of the community which is an essential condition precedent to the former object. The growth of expenditure in this direction has been very large, and presents some serious financial problems.

[1] Farrer, *State and Trade.*

§ 2. Though many of the details of legal development are as yet obscure, its broad outlines have been sufficiently elucidated by the labours of the historical jurists.[1] In the primitive community custom is binding; violations of its prescriptions are offences, but any disputes as to the fact of a breach of the customary rule have to be decided by the opinion of the tribal or village assembly. As soon as the chief comes into existence the decision of controversies becomes one of his tasks—or privileges; the submission of the parties is, notwithstanding, voluntary, at least in appearance, and the Judge is entitled to a 'fee' for his services.[2] Under such conditions, justice is a matter of special bargain. The chief, as judge or arbitrator, gives his time and attention to the decision of disputes, and like any labourer is 'worthy of his hire.' Very many legal systems afford evidence of the existence of this dealing out of the commodity, justice, and of the slow process by which voluntary submission became compulsory.

At a far later stage of growth, and even when the coercive power of the sovereign State was fully established, this idea of 'service for service' was retained. The financial significance of such a view is apparent. As long as the suitors paid fees for the services of judges there was no need for including the item among the heads of public expenditure. Even if entered, it would only be a matter of account, the receipts balancing the outlay.[3]

First appearances are in favour of this arrangement. The public revenue is exempted from charge; the persons who are supposed to gain have to pay for a service rendered; and judges are stimulated to diligence by the hope of reward. The operation of individual interest seems to produce a sufficiently satisfactory result. So plausible is this idea

[1] Maine, *Ancient Law*, ch. 10; *Early Institutions*, chs. 9 and 10; Jenks, *Law and Politics in the Middle Ages*.

[2] Cp. Maine, *Early Law and Custom*, 185 n.

[3] If the fees were so large as to leave a surplus after paying salaries and other expenses, 'Administration of Justice' might have to appear in Book ii. as one of the departments of 'State Industry.'

that it was maintained by Adam Smith. But before his time the practical weakness of the method was so apparent that the abolition of all law charges was advocated, and Bentham had little difficulty in showing the mistake of the older view. It based its case on a series of false comparisons. The judge—and every judicial official—is indeed a labourer discharging a most useful service even in a strictly economic estimation ; but his toil is for the interests of the society at large, and he ought to be paid out of the fund created indirectly through his work, that is, the increased wealth of the society owing to an exact administration of justice and the consequent increase of security. If lawsuits always arose from mistakes, there might be something to be said for compelling the parties in fault to pay for the correction, but this is not the usual case ; far more often they arise from intentional wrong-doing by one party, or in many instances through the difficulty of knowing the law. The innocent suitor is not a special gainer by the action of law ; he is in rather a worse position than those who by the restraining effect of justice have been saved the necessity of asserting their rights. The great advantage that a legal system sustained by fees gives to the rich is an additional argument against it, as is also the tendency of payment by fees to foster judicial corruption. A court supported by charges on suits would be likely to work so as to increase those charges, and might not be strictly scrupulous in the methods adopted.

The theory, besides, is only applicable to civil courts. If we grant that the criminal courts are to be sustained by the parties—one of those parties is the State, and it must draw its contribution from the public funds. A possible source of revenue may be suggested in the penalties inflicted on wrong-doers. Unfortunately this, which so far as it goes is very suitable, proves insufficient. In many cases there is not enough to compensate the individual sufferers. The offender—either civil or criminal—may have no available property, and we therefore find ourselves forced to the

conclusion that the cost of justice should be defrayed by the State. Nor, so long as due care is observed in scrutinising the outlay, is there any form of public expense that is more amply justified. On the due administration of justice depends in a great degree the prosperity of a country. The outlay incurred for it ought not to be regarded as a deduction from a definite and pre-determined fund; it is more correctly a percentage levied on wealth, that but for it would never have existed.[1]

§ 3. In regard to justice, as to defence, it is possible to adopt different methods of supplying the state requirements, consisting in this case chiefly of services. As Germany has given the world the greatest example of forced military duty, affording a model that has been widely imitated, so has England supplied the most striking and impressive instance of compulsory civic service. The jury system of the United Kingdom, though it does not enter into the national accounts, is, notwithstanding, a heavy tax on those who are subject to it and should be considered in estimating the national burdens. Continental legal systems economise in another direction. By placing judicial salaries at a lower scale, the work is done by an inferior class of men,[2] but then they are enabled to employ a larger staff and can secure a quicker disposal of cases. In this they are aided by the superiority in form of their laws. A less skilled judge can deal successfully with the definite rules of a Code, when he would fail under the English method of case-law. But whatever mode be adopted, the total cost of the legal system is not light, as the figures show, and it tends to increase with the growth of population and industrial intercourse.

[1] The statement in the text does not exclude the levying of fees for various legal acts. This side of the question is considered *infra*, Bk. II. Ch. iv., and Bk. IV. Ch. viii. The most important field for levying legal fees is in connexion with Commercial Courts. Traders as a special class may not unfairly be required to defray the expenses of the tribunals that they use.

[2] Promotion on the Continent is said to be from the bench to the bar, a complete reversal of English ideas.

§ 4. Voluntary service contributes towards the performance of judicial work. As England has a volunteer army, so she possesses a volunteer judiciary in the unpaid justices, who discharge the lower tasks of courts of first instance, and are rewarded by the consideration that attaches to their office, and by the reflection that they have 'done their duty.' The Germans, and Gneist in particular, place great weight on the advantages of 'Self-government' as it exists in England and is being gradually introduced into Prussia. It is nevertheless of doubtful efficiency ('justices' justice' has long been a byword), and from the financial point of view the gain is not great. At all events, the system of unpaid magistrates is only suited for thinly peopled districts, where small offences are comparatively few in number, and where the administrators command respect by their social position. Civil cases, above the lowest, have to be referred to a paid official—the county-court judge; and the criminal jurisdiction over large cities is given to well-trained and salaried magistrates, since the work would be beyond the power of volunteer service. Thus self-help, or rather free public service, turns out to be a valuable aid, but impracticable as a sole or even a chief resource.

§ 5. Next to the cost of law, the outlay on 'police' requires notice. The general term 'police' has been used in a wide sense;[1] we may, however, limit it to its modern meaning. In this application it is of very recent growth. Formerly each citizen was in some degree prepared to defend himself, or belonged to some body or group that would protect him more or less effectually against aggression. All difficulties finally came to the tribunals. Now the State is held bound to have a force on hand to suppress disorder and bring criminals to justice. The absence of a police force from any scene of disturbance is regarded

[1] Thus we find 'Police of commerce,' 'Police of grains,' and even the 'Police State,' for a system of paternal legislation. See *Dictionary of Political Economy*, Vol. III., Art. 'Police,' for a full account of the different uses of his term.

as a grievance, the support of order being supposed to concern it solely. A series of causes has tended to produce this remarkable change in public feeling; they are:—(1) The increase of population, and its great density in certain areas, affording naturally a greater facility for escape to offenders; (2) the alteration in manners that has abolished the custom of carrying arms; (3) the modern industrial system, with the consequent accumulation of valuable commodities, many of them incapable of being identified; (4) the development of agencies for locomotion, and the facilities for escape thereby provided, while pursuit, though difficult to an individual, is still easy for an organised body. The financial outcome of the normal forces has been a great increase both in central and local expenditure, for the purpose of maintaining police forces engaged in supporting and facilitating the action of courts of justice, as also in preventing outbursts of disorder.

§ 6. The penal system stands on the borderland between 'police' and administration. When the judge and policemen have dealt with the criminal, he is handed over to the jailor, and in this department of state outlay also there has been a noticeable change during the last century. Ancient societies treated offenders in a summary way. They were executed or reduced to slavery, so that the problems of prison expenditure or management did not arise. The mediæval idea was quite as barbarous, though not so efficient. Criminals who escaped death were the objects of great cruelty, as well as at times of undue lenity.[1]

The more humane spirit of the eighteenth century brought about a salutary change. Under the influence of the teaching and practical work of Beccaria, Bentham, and Howard, continued by their many followers in their various lines of exertion, the whole system of criminal legislation and penalties was remodelled. Punishment, instead of being regarded as the vengeance of the State or the

[1] See Du Cane, *The Punishment and Prevention of Crime*, chs. 1-3.

individual, was transformed into an agency for prevention and reformation.[1] Executions became few in number, and prisons, from being purely places for confinement, were used for purposes of discipline and instruction.

The necessary financial result has been a considerable increase of expenditure. Prisons and convict stations are formed on an elaborate scale, with careful provision for the health of the inmates. The comparative leniency of sentences has further tended to perpetuate the class known as 'habitual criminals.' This small body—for such it really is in all civilised countries—is yet responsible for the greater part of the outlay on 'crime and police.' Any effectual method of dealing with proven 'habituals' would be a financial as well as a social benefit. Even under the present arrangements the outlay on the 'penal system' is in the strictest sense productive, or at least preservative, of wealth.

[1] For theories of punishment see Bentham, *Theory of Legislation*; also T. H. Green, *Philosophical Works*, ii. 486–511; Bosanquet, *Philosophical Theory of the State*, 275 sq.

CHAPTER IV

ADMINISTRATIVE SUPERVISION. POOR-RELIEF

§ 1. The modern State has in some respects added, if not exactly to the classes of objects under its care, at least to the complexity of the tasks connected with those classes. It is still possible to stretch Adam Smith's description of state functions so as to include the subjects of the present chapter, but the extension, though conforming to the letter, hardly agrees with the spirit of that well-known statement. In this instance we have a good example of the way in which public tasks are conditioned by the circumstances of time and place, and of the impossibility of using an inflexible formula to guide the course of social action. The expansion of administrative supervision in the last fifty years has placed a fresh series of duties on public authorities. A century ago there was little of the kind in England, and the older French and German systems of regulation were in a state of decay. The French Revolution of 1789 was believed to have removed these checks on individual liberty, and to have secured by its influence their ultimate abolition in other Continental States. The passage from the *Ancien Régime* was regarded as definitely accomplished.

Such expectations have proved unfounded ; old methods of control and supervision have indeed for the most part disappeared,[1] and no one advocates their re-establishment.

[1] *E.g.*, the restraints so forcibly criticised in Turgot's *Éloge de Gournay* could not exist now. Turgot, i. 266–270.

In their place we have a newer body of arrangements for the regulation of various parts of social life. Under an elaborate system of legislation, a large official staff has been created for the purpose of regulating the free movement of the ordinary citizen. There are inspectors of mines, factories, shipping, railways, tramways, hackney-carriages, &c. The soundness and purity of articles of food are tested by public agents. Many trades are placed under special rules, and local authorities are entrusted with wide discretionary powers in their dealings with the habits and occupations of the communities under their charge.[1] The foregoing account, applicable in all points to the United Kingdom, holds true generally of all modern States; there may be differences in detail; the power which exercises supervision may be local in one country and central in another; nevertheless, the broad fact remains, that in both Europe and America the department of 'administration' is increasing in extent.[2] Opinions may and do differ widely as to the merits of this movement,[3] but on the point most pertinent for our present inquiry there can be no dispute, viz. the increase of expenditure that necessarily results from it. The budget of every civilised society is swollen by the charges needed for the salaries of agents engaged in the work of inspection and regulation, while the total cost can only be ascertained by combining the general and local outlay.

§ 2. Some of the causes of the great increase in administrative outlay have been noticed when dealing with 'police' They, however, deserve a more precise statement:—(1) The growth of great centres of population makes organisation

[1] Farrer, *State and Trade*, and Cunningham, *Economics and Politics*, both describe this movement, but with divergent sentiments.

[2] For the United States, see Bryce, *American Commonwealth*, ch. 91. For the English Colonies, Dilke, *Problems of Greater Britain*, 508.

[3] Farrer and Cunningham, as above. For vigorous protests against the tendency, see H. Spencer, *State and Man*; the recent work, *A Plea for Liberty*; and the publications of the Liberty and Property Defence League; also Léon Say, *Socialisme d'État*.

and control more necessary; *e.g.* to employ a body of police to regulate the traffic on a country road would be absurd; in the Strand or Regent Street it is indispensable. The inspection of dwellings in order to prevent overcrowding is another prominent instance. (2) The moral sense of the community stands at a higher point now than it ever previously did, and as a consequence the public power is invoked to remove any evil that shocks public opinion. The legislation as to unseaworthy ships affords an illustration. (3) The democratic movement makes interference with the owners of capital or property generally, as also with large dealers in commodities, acceptable to the holders of political power. (4) The establishment of bodies of officials is carried on so gradually that the total expense entailed by the system is never realised, while the special gain hoped for in each case is distinctly conceived. (5) Finally, the influence of the prevalent political and economic theories should be added. Most cases of actual state regulation would come under the exceptions to *laissez faire* as discussed by J. S. Mill and H. Sidgwick; they also have been powerfully advocated both in Germany and America on theoretical grounds. It is, therefore, not unreasonable to assume that this tendency of speculative thought has in some degree influenced the conduct of statesmen.[1]

§ 3. The difficult question remains. How far is this outlay financially justifiable? It may at once be conceded that many of the ends sought are eminently praiseworthy, and that no supposed principle of abstract right ought to hinder the adoption of measures of general utility. The final test must be expediency, but expediency in its broadest sense. It is only possible here to indicate some of the general considerations applicable to the problem, and which have to be used as guides in each particular case. (1) The pressure of taxation, and the probable sacrifice that its

[1] For a statement of these causes, Goschen, '*Laissez faire* and Government Interference,' *Addresses*, 59–84.

increase for a proposed new end would cause, or the advantage that would result from its remission. (2) The possibility of voluntary agencies undertaking the work now carried out by the compulsory power of the State. Thus it should be a matter for deliberation how far Trade Unions could insist on sanitary provisions in factories, and associations of consumers guard against adulteration and fraud generally. The danger of weakening the spirit of association by hasty state intervention is not to be overlooked; all the more that it is unobtrusive and cannot be readily weighed. (3) The extent to which administrative action is really effectual in meeting evils, though of extreme importance, is not easily determined. Sweeping general propositions, to the effect that 'individuals do things better than the State,' or that 'the State does things better than individuals,' will not carry us far, but the inertness of human nature when relieved from the stimulus of direct self-interest, and the danger of official corruption, both suggest a presumption against state interference, a presumption it is true of very different force according to the case in which it is used. The solution of the problem belongs to the statesman, who, however, will not form a less sound judgment by taking general principles into account.

It seems perfectly certain that administrative expenditure will continue to increase more rapidly than the cost of justice or police. These latter move with population; the cost of inspection and regulation grows much faster, it is, too, more divided and not so definitely ascertainable, and may therefore be regarded, in common with military and naval expenditure, as presenting the principal difficulty for the finance of the future. Growing expenditure implies increased revenue or additional debt, and either means extra pressure on the subjects of the State. The duty of seeing that all outlay is productive of compensating advantage to the community is more than ever imperative.

§ 4. The relief of indigence is now in most countries one of the charges on the public revenue, and has even become

at times—as in England under the old poor-law—a heavy burden; it has not, however, been assigned a prominent place in the estimates of outlay given by financial theorists. The reasons for this comparative neglect are not hard to find, for (1) it has generally been a local charge, and has not found its way into the national budgets, which used to occupy most attention; and (2) the state relief of pauperism has been one of the contested questions of economic policy. It is probable that Adam Smith, who does not mention poor-relief in his examination of public expenses, disapproved of any form of compulsory aid to distress, and his followers would in most cases take the same view.[1] But though we can thus explain the omission of poor-relief, we cannot accept the reasons as sufficient. From the point of view of public finance, it is immaterial whether the State acts through general or local authorities: *e.g.* in England before the Act of 1877, prisons were maintained by the counties; since the passing of that measure they are under the Prisons Commission; but in either case they involved a public charge. In regard to the second point, finance is engaged in dealing with facts, and therefore the existence of state aid to those in distress is a valid reason for examining the subject. We may at the same time admit that the question of expediency in this respect is a most difficult one, involving as it does reference to a number of political and economic considerations.

The problem presents itself in the following way. In all modern societies there are persons who, by reason of physical or moral causes, are unable to—or at least as a matter of fact do not—provide themselves with the means of subsistence. The question then arises, what is to be done with this class? Ancient societies relieved themselves from the difficulty by the rude expedients of infanticide and slavery. The Middle Ages met it by the inculcation of private charity by the Church, and by the monastic

[1] Ricardo, *Works* (ed. McCulloch), 58-9; Malthus on *Population* (8th ed.), 428 sq.

institutions. In modern times the insufficiency and irregularity of private relief have led to state intervention. The break-up of the mediæval system, and the resulting economic disturbances, made it an urgent matter of public policy to deal with distress. The greater power of the principal European monarchies also furnished the means, in the shape of legislative action, prescribing and limiting the conditions of relief. The growth and expansion of the system of public relief is of itself an argument in favour of its expediency as meeting an evil common to all communities that have reached a certain stage of development.[1]

This simple and obvious ground for the policy has been supported by several arguments of a more theoretical character. (2) Thus it has been urged that the State is 'bound' to relieve distress. The methods in use in ancient times for the suppression of indigence are happily impossible; private charity is not sufficiently regular, and the State cannot with safety so far outrage the sentiments of its citizens as to allow even the poorest to perish by starvation; it therefore has an imperative duty to discharge in the relief of actual destitution. (2) Another contention appeals to justice rather than sentiment. If the relief of distress were left to voluntary exertions, it would in fact amount to an extra tax imposed on the charitable, who would have to pay more than their due share, the niggardly escaping the payment of anything whatsoever towards what ought to be a common burden. (3) In addition to justice amongst taxpayers, the plea of justice to the indigent may be advanced; it may be said that the real cause of destitution is the appropriation of the agents of production by private persons, and that consequently those in distress may fairly claim at least that minimum of

[1] 'Every society, upon arriving at a certain stage of civilisation, finds it positively necessary for its own sake . . . to provide that no person . . . shall perish for want of the bare necessaries of existence.' Fowle, *Poor Law* (1st ed.), 10, who regards this as the 'general principle' and 'cause' of poor-law legislation.

subsistence probably attainable in a state of nature, or—to vary the argument slightly—the holders of property may justly be called on for the amount required for the relief of actual want, in return for the benefits that they obtain from the present social organisation ; *i.e.* they are asked to pay a 'ransom' for their possessions.[1] (4) To these somewhat abstract arguments, a more direct and practical one may be added. Under the present penal system [2] criminals are supported in a way that secures them a tolerable and healthy existence : now to deny to the pauper what is thus guaranteed to the criminal amounts to an inducement to crime.

The force of these several arguments, and the fact of the almost universal existence of public relief, would appear to leave no room for doubt on the subject, but we find to our surprise that a formidable list of arguments may be brought forward on the other side. The opponents of poor-relief contend (1) that to give support to the non-worker is essentially 'communistic,' and that any such system has 'communism' as its logical result ; (2) that aid to distress tends to act on population ; that therefore an increasing number of applicants for assistance would present themselves, until at last the whole revenue of the community would be absorbed in their support ; (3) that state relief demoralises the recipients, while (4) it interferes with the beneficial action of private charity, and injuriously affects the moral sentiments both of givers and receivers. The more extreme foes of relief, public or private, would add (5) that all relief (and therefore public relief) discourages providence and saving. Almsgiving is—as Professor Newcomb puts it—'a demand for beggars'.[3] The industrial and economic virtues are, it is said, weakened by every attempt at distributing aid. Finally, (6) evidence has been adduced to show that poor-relief lowers wages, since it allows the lowest sections of the population to

[1] Sidgwick, 'Economic Socialism,' *Fortnightly Review*, Sept. 1886.
[2] Bk. I. ch. 3, § 6.
[3] *Political Economy*, 526.

work for less than the amount needed for subsistence by the amount of relief that they get from the public authorities.[1]

§ 5. To strike a true balance between the opposed arguments that have been just stated is indeed difficult, but for financial discussion it is possible to arrive at a satisfactory result. In the present position of most modern societies a methodised system of public relief is indispensable, and therefore forms a legitimate part of public outlay; nor is it hard to fix approximately the standard of relief. If the treatment of the pauper should be better than that of the criminal, it should, on the contrary, be worse than the standard of living of the poorest self-supporting labourer, and unhappily the limits as thus determined are very narrow. For financial as well as for social and moral reasons all relief should be given in the form prescribed by the State, *i.e.* generally 'indoor maintenance.' Assistance from public funds is not 'charity,' from which it should be clearly and distinctly separated, and in no way can this be better accomplished than by confining the action of the public agents engaged in relief to a definite sphere. It may be further said that in the administration of poor-relief the reformation of the habits of those who are indigent should be aimed at. What the habitual criminal is in the prison the hereditary pauper is in the poor-house. Expedients calculated to improve the *moral* of the destitute would powerfully affect the productive forces of the nation.

The relations between the system of legal aid and private charity are of extreme importance. One of the most serious blots in the usual poor-law arrangements is the absence of any connexion between the two classes of agency. We can hardly doubt that the contributions of private persons, properly utilised, would go very far towards meeting the necessary outlay on those in distress, with the double advantage of economising the public funds for other objects, and preventing the evils that result from

[1] See J. E. T. Rogers, *Economic Interpretation of History*, 487.

the existing abuses of almsgiving. Discrimination as to the causes of distress, and consequently the amount and character of relief, can be properly applied only through the operation of private beneficence.[1]

§ 6. In addition to the direct relief of indigence, the State has been called on to meet the difficulty either by instituting a system of public works, by granting old-age pensions, or by compulsory insurance on the part of the workers. The assertion of the 'right to obtain work' supplied by the State is distinctly of French origin.[2] It has never obtained full recognition in practice, as the difficulties it would cause are evidently insuperable. The provision of work, the mode of supervision, the rate of pay, and the disposal of the products, are each and all so many obstacles in the way of its adoption. The economic effect on the whole working class would, moreover, be surely evil; the expenditure would be indefinite, and not capable of easy control. A general system of pensions for the aged would undoubtedly provide for one large section of the pauper body, but it would at the same time necessitate a great increase in the public burdens. To add £16,000,000 to the annual expenditure of the United Kingdom would involve a grave disturbance in financial equilibrium, which could only be restored by a series of retrograde measures in respect to taxation. Without pronouncing any opinion on the social and economic aspects of the various pension schemes lately put forward, it is here in place to dwell on the serious financial difficulties that their adoption would be certain to create, and which by themselves suffice to make any step of the kind one of very doubtful expediency.[3] 'Compulsory

[1] In an interesting article on 'Old Age Pensions' (*Economic Review*, iii. 475–85), Mr. Phelps shows the effective working of private charity in supplementing and modifying the rigour of the legal provision.

[2] *Droit au Travail*, quite different from the *Droit du Travail*.

[3] Mr. C. Booth's *Endowment of Old Age* contains the best statement of the case for old-age pensions. See especially chap. vi. for the financial aspects of the subject. Mr. Booth contemplates calmly the reimposition of the sugar duty, increased taxation on tea and 'drink,' 3*d*. additional on the income-tax,

insurance,' as advocated in England, and in some degree carried out in Germany, is less open to criticism on the financial side, but it may be remarked that the collection of the insurance charges is likely to be ineffective in a country where labour is allowed full freedom of movement, while the scheme involves the State in extensive financial operations, and at the same time weakens the action of voluntary effort. The English friendly societies even now insure a large number of the more provident artisans, and have been favourably contrasted with the foreign state insurance bodies by Mr. Goschen.[1] A strict administration of public relief encourages the habit of insurance, or other provision against distress, and the development of such methods of self-help makes it easier for the State to adhere to the rigid policy of relieving nothing except absolute indigence.

with 'an adjustment of death duties in reserve.' It may be fairly asked what resources would remain for use in case of the outbreak of war, with its inevitable pressure on the national earning power. The additional inquiries by the Commission on 'The Aged Poor' (1895) and the Departmental Committee on pension schemes, also the evidence taken by Mr. Chaplin's Committee, appear to establish the immense difficulties in the way of any general pension scheme. The effect on the British finances of the South African War proves the justice of the criticism made in this note on Mr. Booth's proposals.

[1] *Addresses*, 113 sq.

CHAPTER V

EDUCATION. RELIGION

§ 1. The recognition of education as one of the tasks of the State was a natural result of the decline of the influence of the Church. The innumerable religious institutions of the Middle Ages had provided instruction for youth, as they had provided sustenance for those in need, and when their endowments were in great part seized by the different European sovereigns, some provision in their place, or by their diversion to the supply of education, was obviously suggested. Even the theorists of the eighteenth century hesitated to exclude the duty of assisting education from the sphere of state operations. The Physiocrats and Adam Smith agreed in recommending state aid to education, but only under such conditions as would encourage efficiency in the teachers, with industry and application in their pupils.[1] Since their time the tendency has been towards the extension of public effort in all the departments of education. The question presents itself in connexion with each of the three forms of teaching, primary, secondary or intermediate, and university.

[1] The attitude of the Physiocrats on the subject of education is remarkable, and helps us to understand their general conception of state policy. It was not so much *interference*, as *injurious interference* that they opposed; but they felt that all state action had elements of evil in its disturbance of voluntary action, and in its expense. Turgot, ii. 502–551, *Mémoire sur les Municipalités*, said to be the composition of Du Pont de Nemours. Cp. Schelle, 362 sq.

§ 2. In respect to primary education we may note the distinct expression of opinion by Adam Smith in favour of state facilities for this form of teaching. The success of the Scotch parish schools had evidently impressed him, and he contends with great force that the increased division of labour due to economic progress tends to weaken the faculties of the workman, and that this evil can only be counteracted by education. The State has moreover, he thinks, a direct interest in the education of the bulk of the people in order to secure political tranquillity.[1] A mild form of compulsion is even allowable, since he suggests that passing an examination should be a necessary preliminary to entry into a trade. Adam Smith does not advocate free education, but his reason is curious, viz. that the teacher's diligence is stimulated by the receipt of fees, an aim that would be otherwise reached through the modern result-fee system.

During the present century the state-guided system of primary instruction has become definitely established, as an examination of the details of expenditure will most clearly show. The development of this system has brought out the existence of several difficulties imperfectly recognised at its commencement. Among those are :—(1) The problem of religious teaching ; denominational schools are offensive to one section, undenominational ones to another ; and both the amount and application of state funds are hotly contested by the different parties. (2) Distinct from the foregoing, but connected with it, is the relation of state to voluntary schools. If no fees are charged in public schools, the private schools complain of the unfairness, which indeed is manifest. On the other hand, fees—especially if education is compulsory—press heavily on the poorer parents. (3) When, to avoid some of the foregoing puzzles, payment by results is made, there is a danger of superficial preparation ; and yet without some test of the kind, efficiency cannot easily be measured. The only

[1] *Wealth of Nations*, 329–30. An argument also urged by Malthus, *Essay on Population* (8th ed.), 437 sq.

complete escape from such difficulties would be the abandonment of instruction to voluntary effort, a solution which is forbidden by the importance of education, both socially and economically, as also by the practical impossibility of securing it without state aid in the case of the very poor.

§ 3. Secondary education is in a very different position. The older economists would abandon it to the action of individual and family interest. There is, it would appear, no pressing ground for state exertion in order to supply instruction superior to that enjoyed by the whole population. It may, therefore, reasonably be left to private initiative or to voluntary effort, more particularly in the form—too often disregarded by economic and financial theorists—of endowment by gift or bequest. The modern tendency is here, too, in favour of an extension of state action, generally directed rather to supervision and readjustment of existing resources than to the supply of additional funds. In some instances special agencies for testing the quality of secondary education, either by inspection or examination, have been created.[1] From the financial point of view, it must be said that outlay of this kind is not to be placed in the same rank with that in aid of the primary instruction of a country. At best it belongs to the class of useful outlay, and is very likely to be supplied by private funds. It, moreover, is open to the objection of benefiting but one, and that the most independent, section of the population. Against these weaknesses it may claim to be of a moderate character, and not likely to seriously affect national finance.[2]

§ 4. Universities, or, more generally, institutions for higher education, have to be judged on special grounds so far as their claims for state aid are concerned. It is quite true, as Adam Smith shows, that the higher education in

[1] Provision of this kind was made for Ireland in the Intermediate Education Act, 1878.

[2] Secondary education is likely to become an increasing charge on the State, owing to the general desire to 'organise' it and supply it to all who may desire to obtain it.

many cases is not a necessity, but rather a luxury or ornament that may very well be paid for by the wealthy, if they desire it for themselves or their families. In most of the remaining instances it is a legitimate investment in immaterial or personal capital, a point of view that predominates in the minds of the professional and commercial classes, so that on either supposition there is no call for public intervention. State or other endowments have besides, the injurious effect of checking the easy remodelling of the system of higher instruction in accordance with the inevitable changes in scientific and literary studies.[1] There is unfortunately a tendency on the part of highly paid permanent teachers to take their work in a mechanical manner, and expend their energies in other directions. The result of such considerations leads to the suggestion of thorough reform in the mode of higher education, rather than complete surrender on the part of the State of its regulating functions, more especially when some less obvious parts of the working of Universities are taken into account.

The modern University has very different elements, and may be looked at from different points of view. In the first place, it is a grouping of professional schools, and here the tendency towards extended administrative action almost compels the State to form closer relations with the larger teaching bodies. The increase in the number of professions, entry into which is granted only on supposed proof of competence, as evidenced by examinations and courses of study obtainable solely by means of attendance at a University College, affords a strong reason for offering facilities towards getting the necessary instruction. When

[1] 'The improvements which in modern times have been made in several different branches of philosophy, have not the greater part of them been made in Universities. . . . The greater part of Universities have not been very forward to adopt those improvements after they were made, and several of those learned societies have chosen to remain . . . the sanctuaries in which exploded systems and obsolete prejudices found shelter and protection after they had been hunted out of every other corner of the world.' *Wealth of Nations*, 323.

the State imposes on candidates for various offices or professions the obligation of having a University Degree, or something similar, it is in fairness bound to supply them with reasonable opportunities for acquiring that needful badge. Moreover, many parts of administrative work could hardly be carried on without the aid of the scientific skill maintained by the teaching bodies.

Secondly, the importance of scientific research in its effects on the production of wealth, and in dealing with many social problems, is now abundantly recognised. Even literary and historical inquiries are found in many cases to be of practical service, and to powerfully aid in the advance of culture. The 'endowment of research' is a matter, if not of practical politics, at least of discussion. A University, however, is, or at least ought to be, the home of research, and its support by the State may be claimed on the ground that it discharges this most valuable function. Possessing these two departments, which may reasonably expect aid from public funds, a University naturally adds to them a third in supplying to the richer members of the society the ornamental education or 'culture' that they demand and are willing to pay for. By this combination it is further possible to stimulate the teachers by fees that will largely depend on the reputation and credit of the institution where they are placed.

§ 5. The question of 'technical' as opposed to general education presents itself in all the stages of instruction, and in each it raises the same problems. The evident economic advantage that a nation obtains through the skill of its producers is a *prima facie* ground for State aid being given towards the attainment of suitable training. Expenditure for such an object is productive even in a financial point of view, and it may be further argued that individual or family interest will not suffice to accomplish the end desired. On the other hand, the sturdier individualists urge that self-interest, if good for anything, should surely be good for inciting men to learn in the most efficient manner

the trades or occupations by which they have to earn a livelihood. The same general result is reached here as elsewhere, viz. that the true test is experience, and it shows that public outlay may be of advantage in promoting industrial training, though it is subject to the inevitable drawback of all state interference in its tendency to reduce private exertion, and in the difficulty of duly regulating the supply of skilled labour called out by its action. The acquisition of training for unprofitable employments is no slight evil, and under the rigid system of regulation inseparable from official management it is not unlikely to occur. Even general education may produce a *surmenage scolaire*, as the example of France shows.

§ 6. Under the same head the cost of museums, libraries, picture galleries, and institutions for promoting science and art generally should be placed. They come in to supplement the more directly educational agencies, and are often quite as effective in promoting the ends aimed at. The modern development in this domain is remarkable (especially in England and the United States). Central and local authorities have both made considerable efforts in the direction of meeting the wants of the population for opportunities of acquiring information and culture. Few large towns are without appliances that were unknown a century ago, or confined to national capitals We have to add this expenditure to the cost of schools and colleges before we can say what is the total sacrifice incurred by a nation in its public capacity for the object of culture.

§ 7. Voluntary action may be expected to relieve the revenues of the State from a great deal of this charge. Not only are the expenses of education largely met by the normal economic process of payment for advantages obtained ; the donations and bequests of the wealthy have supplied, and we may hope will continue to supply, a good many of the less profitable fields of instruction and research with sufficient endowment. The splendid example set by American

millionaires may produce good effect in Europe by attracting attention to the benefits of supporting the educational and investigating bodies to which civilisation owes so much.[1]

In any case, it must be said that no modern State is likely to suffer financial embarrassment through its outlay in promoting education and culture. Measured against the cost of war, and preparation for war, this form of expenditure is modest and inconspicuous in the total amount; and taken with its probable advantages, it is the least questionable of the many secondary heads of charge.

§ 8. The relations of Church and State have been at different periods the principal problem of rulers. The earlier sentiment rather included the State in the Church than the Church in the State. Modern societies are practically agreed in reversing this position. Excluding the polemical sides of the subject, we can see that for the financier the religious wants of the community need the supply of particular forms of services and commodities, and the question arises whether the public authority should provide these needed objects or leave them to private effort. Historical conditions have determined the actual solution in each country, while the prevalent theoretical view is derived from the doctrines of the last century. Adam Smith, who approached the subject under the influence of Hume,[2] regards the clergy as a particular form of police attending to spiritual interests. His ideal is complete non-intervention on the part of the State. The probable result would be a 'great multitude of religious sects,' whose fanaticism might be kept in check by the two remedies of: (*a*) 'the study of science and philosophy,' and (*b*) 'the frequency and gaiety of public diversions.' Where, however, there is one predominant religion, the State ought, he

[1] Cp. Cohn, § 150. The donations of Mr. Carnegie and such bequests as those of Mr. Rhodes are recent instances of this tendency.

[2] See his quotation from the latter (*History of England*, ch. 29), whom he describes as 'by far the most illustrious philosopher and historian of the present age.' *Wealth of Nations*, 331.

thinks, to regulate and control, or, to use his significant term, to 'manage' it—a process that is best carried out by the skilful use of the power of bestowing preferment. Religious endowments are regarded as a part of state wealth withdrawn from the more pressing end of defence.[1]

The circumstances of the case have, it need hardly be said, been profoundly altered since 1776. The United States now afford a remarkable example of the actual working of the policy of *laissez faire* in respect to religion,[2] and they are imitated by the English colonies. Continental nations show a different set of changes: the 'Established Churches,' with their numerous independent and private funds, have given place to bodies directly chargeable on the State revenues. The 'enlightened absolutism' of the eighteenth century commenced the work of disendowment, which was further carried out by the revolutionary movements since 1789. Later reaction has made the clergy pensioners of the State. As regards the United Kingdom, the American example has, for special reasons, been followed in Ireland, and seems likely to be extended to Great Britain.

Viewing the question as one of finance, it appears that the expenditure on religion, though not large, can be easily supplied by voluntary contributions, and therefore is not an urgent call on public resources, which can be better used for other objects. When the State, for political motives, undertakes the supervision of religion and its supply, concurrent endowment is a necessity in modern societies, as otherwise an evident injustice would be inflicted on the non-endowed sects. Such is the policy of most States at present, but it is more expensive, owing to

1 'The revenue of every established church . . . is a branch, it ought to be observed, of the general revenue of the State, which is thus diverted to a purpose very different from the defence of the State.' *Wealth of Nations*, 341.

2 'Congress shall make no law respecting an establishment of religion.' *First Amendment to U.S. Constitution.* Some State constitutions contain a similar provision. Bryce, *American Commonwealth* (2nd ed.), ii. 570–1.

the greater number of ministers, buildings, &c., that have to be provided.

The provision for religious teaching has a rather close affinity to that for education proper. Modern budgets often combine the two charges under a single head. There is also an historical connexion between them, and it is noticeable that in countries such as the United States and the English colonies, where state endowment of religion is given up, educational bodies take the vacant place. Public expenditure for denominational education is a near approximation to state aid to religion.

CHAPTER VI

EXPENDITURE ON INDUSTRY AND COMMERCE. CONSTITUTIONAL AND DIPLOMATIC EXPENDITURE

§ 1. EXPENDITURE for directly economic objects has often occupied a large place in public outlay. To foster industry and commerce was long regarded as a leading function of the State. In fact, it is to this conception that we owe the origin of finance and political economy.[1] The great object of the *Cameralwissenschaft* of the eighteenth century was to give instruction as to the right direction of national resources, and most of the earlier economic writers of France and England held that it was very important to encourage economic enterprise.

The complete revolution wrought by the combined labours of the Physiocrats and Adam Smith exonerated the State from this difficult, indeed impossible, task; but it is a vulgar error to suppose that the advocates of industrial liberty did not recognise certain definite duties of the State in economic matters. Apart from the exaggerations inevitable in so violent a change of opinion, we see that the sound sense of Adam Smith and Turgot fully understood that in several directions the Government could beneficially aid the efforts of producers.[2] The necessities of practice have made it incumbent on States to undertake

[1] Introduction, chap. 2.

[2] *Wealth of Nations*, Bk. v. ch. i. part 3, art. 1, 303 sq. Cp. Turgot's statement of Gournay's views in the 'Éloge,' i. 279.

a series of duties intended for the advantage of industry and commerce.

There is, however, a distinction to be made at the outset. In one sense all state expenditure may be said to be for the benefit of industry. The armies and navies of modern States are productive of the security needed for the full development of industrial effort. The administration of justice and the maintenance of an efficient police have the same effect. A great deal of administrative supervision has, or is supposed to have, considerable influence in increasing production. One of the strongest pleas for aid to education is based on its economic value, and writers of the school of Hume would regard the inculcation of honesty and frugality as the most useful function of the clergy. So close is the consensus of social phenomena, that there is no part of public expenditure that may not aid the progress of economic production.

§ 2. But besides this more general action of the State on industry, there is a special one. Portions of the public revenue are devoted to objects either solely or principally economic; and it is the employment of this part that we have now to consider. It, again, may be divided into expenditure on industry and commerce generally, and that on special trades or employments. Of the former we may notice the following as the most usual: (1) the cost of maintaining a monetary system, as in the case of the English gold coinage; (2) the establishment and preservation of a system of weights and measures; (3) the enactment (as in some countries) of a commercial code, with possibly a special tribunal or tribunals; (4) the maintenance of agencies for facilitating communication and transport, viz., post offices, telegraphic communications, roads, railways, and canals; in the same group may be included lighthouses, surveys of coasts or new countries; (5) consular and diplomatic establishments, chiefly for the benefit of foreign trade, but with an indirect action on home industry.

The slightest glance at the above list at once suggests a

criticism. Some of the agencies included, will, under proper management, yield a profit to the State, and seem therefore more fitly to belong to the domain of state industry. The English Post Office and the Prussian railways earn large net revenues for the States to which they belong, and the currency system may, by the imposition of a seignorage, be made to cover its cost, and probably leave a surplus. The answer to this difficulty is not hard to find. Granting the truth of the assertion on which it rests, the fact remains that in many cases the State has to incur cost for the objects mentioned. The gains of post offices and railways will be noticed in their proper place.[1] There are, however, some that have a recurring deficit,[2] which has to be met out of the funds derived from other sources. We get but one more illustration of the difficulty of drawing 'hard and fast lines' in social inquiry. What is in one country a cause of expenditure is in another a cause of gain as a state industry, while in a third it yields revenue through taxation.

§ 3. State aid to special branches of industry presents much greater opening for objections; but here, too, suitable cases present themselves. Among these are:—

(1) The introduction of new and profitable industries In modern times this part of state action has been usually carried out by means of protective duties. The so-called 'infant industry' argument is one of the best of the protectionist pleas, and its theoretic force has been recognised by most economists, but the question is really a wider one. The problem before the statesman amounts to this: How far is it expedient to incur a present loss for a future gain? And on the financial side the balance of the different public wants, as also the percentage of the national income absorbed by the State, are elements to be taken into account in the actual solution. In its simplest form, encouragement is given by means of bounties on production, or premiums

[1] Bk. ii. ch. 3; Bk. iv. ch. 8.

[2] *E.g.* the Indian and Canadian Posts and most of the Continental state railways.

for the establishment of new industries. A protective duty may be regarded as a tax on the consumption of the protected article, with an equivalent bounty to the home producer; it is, therefore, in reality more complicated than a simple bounty. This aspect of the matter may be reserved for a later stage of our inquiry;[1] but here we have to note the difficulty of escaping corruption and favouritism in the application of a policy of encouragement. In an undeveloped industrial system, such aids, if applied with wisdom, may afford a beneficial stimulus, as was probably the case with some of the measures of mediæval sovereigns. They, in some degree, occupy in economic policy the place that despotic government holds in political evolution, but appear quite unfitted for a progressive system of industry.[2] The direct support of special branches of production from the public revenue is sure to be a diminishing item of charge in modern countries.

(2) The promotion of inventions, by the inducement of state premiums, or even the encouragement of a higher standard of excellence in production by the same means, has been regarded without disapproval by Adam Smith. Their effect is not to disturb the natural distribution of employments; besides, as he remarks, their cost is insignificant.[3] A good patent law will, however, be the most effectual way of facilitating invention.[4]

(3) The periodical holding of exhibitions of industrial products under state auspices, and in fact at the State's expense, is now an established custom, though it is prob-

[1] Book iv. ch. 7.

[2] The fact that the Anglo-Indian Government has adopted a policy of non-intervention, so far as trade and commerce are concerned, is the more remarkable, since if ever there were a case where rulers might be supposed to be fitted by superior wisdom and insight to direct their subjects, this would be one. But cp. Bk. ii. ch. 3, § 3, for the treatment of industry.

[3] *Wealth of Nations*, 213.

[4] See *Quarterly Journal of Economics*, Oct. 1890, 44-69 ('A Century of Patent Law,' by Chauncey Smith), for the effects of the United States patent laws.

able that the need of agencies of the kind is at present less than it formerly was.[1]

Other expedients are: (4) model institutions, such as agricultural schools, &c.; (5) state subvention of railways and means of transport for the improvement of the poorer districts of a country; (6) outlay on the administration of forests and drainage;[2] (7) the support of credit institutions and assistance by loans.[3]

§ 4. Finally, we should remark that the State may find itself called on to act in relation to any economic interest of the society that it regulates. There is no strict and universally binding rule that can mark off the area of its action. The protest of *laissez faire* was directed against the policy of continual interference. The intervention of the public power should, however, be only admitted on clear and definite proof of its advantage. The best safeguard against excessive state action is to be found in insistence on a careful calculation of all the elements entering into each case, and more especially of the financial relations that it necessitates.

The actual figures of modern budgets do not indicate much danger from the purely economic action of the State. Some exceptional cases occur where the zeal of politicians has led them to develop the system of public works beyond legitimate limits. Thus the several States of the American Union at one time engaged in a reckless policy of internal improvements that culminated in the repudiations of 1840–50.[4] The plans of the French minister, De Freycinet, for railway extension were also arranged on too extensive a scale, as their subsequent abandonment proved. The

[1] On the economic effects of exhibitions, see Cherbuliez, *Précis de la Science Économique*, ii. 31–33; Droz, *Essais Économiques*, 454–7.

[2] This seems more properly to belong to the subject of the 'public domain,' as it usually gives a surplus. See Bk. ii. ch. 2, §§ 8, 9.

[3] The depression in agriculture has led to increased state assistance in most European countries. Denmark and Würtemberg are noticeable instances. The Irish 'Department of Agriculture' and 'The Congested Districts Board' are attempts of a similar kind.

[4] H. C. Adams, *Public Debts*, 317–342.

public works of India have furnished a ground for bitter controversy; but the opponents of the policy have hardly made out their case, though under the special circumstances of the country greater moderation might have been advisable.[1]

§ 5. We have kept for the last one of the most essential parts of state expenditure—that incurred for the maintenance of the central organs of the State itself. No matter what be the form of government, the head of the State, 'the Sovereign,' in Adam Smith's phraseology, must be supported. Round this personal head are grouped the various branches of the executive, and in some relation to it the legislative body also exists. In a so-called constitutional or 'limited' monarchy—the prevalent European form of the 19th century—the head of the State may possess a private income, but is far more likely to be paid out of the Civil List. The royal or crown lands are generally absorbed in the public domain, and in any case they must in strictness be regarded as a portion of public property, set apart from the general funds for a specific public object. This application of public revenue is necessary, though it often excites an amount of popular irritation that might be more advantageously exerted in other directions.[2] The head of the State is frequently called on to discharge ornamental functions, requiring a good deal of expenditure, and has, moreover, to hold a higher position than the wealthiest of his subjects.

§ 6. A republican State is partly relieved from this expense; its head, usually elected for a short term, receives the salary of a minister in monarchical States. There is, however, a counterbalancing cost in the expenditure on the numerous members of the corporate sovereign.[3] Nearly

[1] Cp. Fawcett, *Indian Finance.* For a vigorous defence, see Strachey, *The Finances and Public Works of India* (1869-1881).

[2] For the position of the King's revenues, *infra*, Bk. ii. ch. 2. Cp. Roscher, §§ 9, 117; Wagner, i. 401 sq.

[3] A comparison of the cost of the English Monarchy and Parliament with that of the United States President and Congress shows that the latter is on the

all democratic societies approve of payment to legislators, in order to reduce the chances against poor men being elected. The inevitable result is an increase in the cost of the legislative body ; and when the same principle is applied to subordinate legislatures, a further increase has to be faced. The belief that legislative efficiency is improved by reward does not appear well-founded so far as finance is concerned. We must remember, however, that historical conditions, and particularly the way in which wealth is distributed, have considerable effect in determining the wisest course. Thus the English colonies that possess responsible government are perhaps justified in departing from the English method of unpaid legislators. At the same time, there is an unquestionable advantage in the development of public spirit produced by the English system. One point is certain, viz. that the least satisfactory method of all is the granting of small payments which do not attract the best men, while they discourage those who would serve without any salary. The danger of corruption is brought to its highest in the case of ill-paid legislators, who are inclined to supplement their official incomes by less honourable means.

Expenditure on diplomatic agents and ambassadors may perhaps be best placed under the present head. Such outlay is hard to classify. It might be plausibly regarded as incurred for the sake of securing peace, and therefore be added to the cost of the military and naval services. Or, again, it might be regarded as expenditure for economic objects, viz. the promotion of trade, as the consular service undoubtedly is. But on the whole the diplomatic staff is really representative of the sovereign, and is entitled to its present position.

§ 7. In nearly every civilised country the charge of

whole more expensive. This curious circumstance is the consequence of the non-payment of the members of the English Houses. Admirers of the American system would remark that British peers and M.P.'s obtain indirect rewards that are still less to the advantage of their country.

interest on debt has to be considered. We shall have, later on, to examine more closely the theory of public credit and debt, and therefore need only mention it here as an item of outlay.

When dealing with the mechanism of the financial system, we shall find it desirable to distinguish carefully between gross and net revenue, the former being the total receipts, the latter the net result, deducting the cost of collection and the expenses necessary for obtaining the required resources. Here we have simply to note these charges as one of the parts of public expenditure, and to see how large an item they are. In England, the Customs, the Inland Revenue, and the Post Office are mainly earning departments. The mere mention of these establishments will suggest the remarkable differences in the relation of revenue to cost of collecting or earning it. Savings in this respect are as important as those made in connexion with outlay on other state functions, but any reduction of cost which impairs the efficiency of the fiscal service is as imprudent as over-retrenchment in other directions.

The cost of collection, or earning, of revenue in the leading English departments is given in the annexed table.

Having concluded our examination of the forms of state expenditure, we have now to summarise the results, as also to develop some points that could not be properly treated until the several heads of the public services had been duly noticed. There is, however, one topic that must be first discussed, viz. the distribution of state outlay between the central and local powers.

TABLE (000's omitted).

	Customs.			Inland Revenue.			Post Office.		
Year.	*Receipts.*	*Cost of Collection.*	*Percentage.*	*Receipts.*	*Cost of Collection.*	*Percentage.*	*Receipts*	*Cost of Collection.*	*Percentage.*
	£	£		£	£		£	£	
1875	19,289	1,022	5·3	43,938	1,672	3·8	6,790	5,077	74·
1880	19,326	973	5·	47,624	1,810	3·8	7,770	5,213	67·
1890	20,424	905	4·5	52,990	1,749	3·3	11,770	8,303	70·
1901	26,271	838	3·2	83,300	1,995	2·4	17,250	14,471	83·

In 1806 a gross revenue of £58,255,000 cost £2,797,000 to collect, or 4·8 per cent., while in 1826 the charge for collecting £54,840,000 was £4,030,000 *i.e.* 7·3 per cent.

In France the total expense of collection for the ten years 1883–92 averaged about £13,000,000, but of this amount £5,000,000 should be charged to the postal and telegraphic service and nearly £3,000,000 to the expenses of the tobacco monopoly, leaving a balance of £5,000,000 for the cost of collecting the direct and indirect taxes.[1] The total charge has risen since. It stood at £14,600,000 in 1893, and has advanced to £16,100,000 in 1901.

[1] Leroy-Beaulieu, i. 267 sq. ; Wagner, iii. 432–4, 607–10.

CHAPTER VII

CENTRAL AND LOCAL EXPENDITURE

§ 1. Up to the present we have taken no notice (except incidentally) of the division of duties between the central and local organs of the State. For the object that we had in view, this mode of treatment was quite legitimate. In order to bring out the fact that all expenditure by public bodies is really one in kind, and that any differences are subordinate and secondary, it is advisable to set forth the leading forms of that expenditure in a general and comprehensive manner. The principles that determine the distribution of public functions between central and local powers, or even between federal and state governments, though highly important and influential on financial policy, are yet immaterial when we are considering the broad grouping and effect of the cost of maintaining those compulsory agencies that we place together under the title of 'the State,' and the expediency of extending or contracting their field of operations. It is, besides, impossible to draw a precise and definite line, applicable to all or most countries, between general and local expenditure. What is retained in one country or period in the hands of the central authority is in other places or times delegated to subordinate bodies; or, to regard the subject from a different aspect, which is in some cases more in accordance with historical fact, the older and smaller groups have reserved from the encroachments of the State very different amounts of power in different ages and nations.

Examples of this diversity in usage are abundant. The transfer of the English prisons from local to central management has been already mentioned.[1] The older system of poor-relief in England was purely local. The great reform of 1834, though it did not go the length of making the aid of the indigent a national charge, yet accepted, and was based on, the recommendations of the Poor-law Commission in favour of complete and efficient regulation of local administration by a specially formed central board. The treatment of primary education affords another example; in England and Wales it is largely under local management, while in Ireland the national school system is strictly centralised. The police systems of the United Kingdom also show like differences in administration.

On extending our view to other nations, we find a similar absence of uniformity. The powers of a Swiss Canton or an American State are far greater than those of an English County or a French Department. Even limiting the comparison to countries with constitutions of the same type, there is still much variety in the actual division of duties.

§ 2. Such remarkable differences have arisen from more than a single cause, but undoubtedly the most powerful reason is to be found in the peculiar historical conditions under which States have been formed and developed.[2] To explain, *e.g.* the diversities in the distribution of public duties in France and Germany, we must see how the governments of those countries have been formed. In no other way is a full interpretation possible. The centralised system of French administration goes back further than the Revolution of 1789; it is a product of the absolute monarchy and of the consequent impossibility of developing local authorities.[3] The greater division of state power in Germany is

[1] *Supra*, Bk. i. ch. 4, § 4.

[2] 'Es ist vor allen Dingen der Reichthum historischer Veranlassungen und historischer Besonderheiten, welcher diese Verschiedenheiten erklärt.' Cohn, § 115. Cp. Thorold Rogers, *Economic Interpretation of History*, ch. 22.

[3] Tocqueville, *Ancien Régime*, Livr. ii. ch. 2 (Eng. Trans. 40 sq.).

one result of the unhappy conflicts that prevented its attaining to national unity till the present century. In order to comprehend it, we must know the history of the Holy Roman Empire, and its many changes. Exactly similar are the cases of Switzerland and the United States ; each is the product of special conditions. The nature of American state and local governments is effected by the circumstances of the colonial institutions from which they have sprung. At all stages of formation this influence is powerful. It is due to the particular events of the time that Italy, at almost a single step, reached the full unity of France or England, while Germany as yet retains so many traces of the process by which it has been formed. There is nothing of rigorous necessity in the course of development ; circumstances that may be regarded as accidental have had most effect in deciding the result, and there seems, consequently, little place for the employment of scientific explanation in so purely empirical a matter.

Historical conditions are, however, often the result of deeper forces ; the political destiny of a nation is not altogether at the mercy of events. The physical features of its territory, the character and sentiments of its members, go a ong way in determining its constitution. We cannot doubt that the mountains of Switzerland, and the enthusiasm of its citizens for independence, have contributed towards the great vitality of its local institutions ; but then it is also true that circumstances somewhat analogous have not hindered Holland from becoming a centralised State.

§ 3. The most complete recognition of the preponderating influence of historical and physical agencies in determining the actual division of state duties between the central body and the local ones, ought not to prevent us from endeavouring—as far as possible—to disentangle from the mass of material any ascertainable general principles. There seem to be—quite apart from national peculiarities—some tendencies, operative in all societies, which assign particular duties to the central agency and place others

under local supervision. An examination of the several public wants will, we believe, confirm this view, showing that some of them can be best satisfied by local management, and that others should, in order to attain the desired object, be supplied through the central organisation of the State.

In making this distribution by reference to general principles, it is necessary to take into account the historical influences that we have previously noticed. They partly determine, not only what are, but what should be general, and what should be local tasks. What has been for a long time confided to local administration ought not without good reason to be transferred to the general government, as, on the other hand, where, from any cause, little has been left to local action, the devolution of tasks by the central administration should be gradual and cautious.

§ 4. Additional light is thrown on the leading principles and present position of the distribution of powers between local and central organs, by consideration of the fact that two different tendencies have been in operation during the course of history. Political evolution is not a direct movement towards a definite goal; it is rather a series of efforts following the line of least resistance at any given time. Early societies do not exhibit the opposition or distinction between central and local powers. All government is local either in the tribal system as found in Germany, or in the city states of Greece and Italy. War—and its result, conquest—is the introducer of centralisation. The smaller groups are unable to withstand the successful military chief and have to submit to his rule. The municipal governments of the classical age—for such they were in fact—passed at last under the dominion of Rome, which gives us the picture of a vast administrative organisation employing local authorities as the instruments of its working. The originally autonomous city was ultimately reduced to take commands, even as to the smallest details, from the Emperor

and his officials.[1] Some place for local co-operation was allowed under the earlier Empire, and up to the last the expenditure of towns was distinct and separate from that of the Imperial government.[2]

Mediæval society shows a movement towards the revival of local privileges. In all European countries the cities succeeded in acquiring a large amount of freedom in dealing with their own affairs. In some countries—as Italy—they ultimately attained independence, and in all they were enabled to apply their resources for purposes of local interest. One of the principal features of the steadily growing consolidation of States in modern times has been the reduction in power of the various semi-independent bodies within the State.[3] Provincial liberties have been curtailed, and particular immunities, whether of towns, districts, or associations, have had to give way to the rule of uniform rights and duties. With great varieties in the process in different countries, the same general result has been reached by the absorption of all independent political forces in the single organ of the State. This point was sooner attained in England than in France, and in France than in other Continental States, but except where a federal system has preserved the authority of one group of bodies, it is now accomplished in all civilised societies.

The establishment of a controlling and legally omnipotent government, though it marks an important stage in political growth, is nevertheless accompanied by some disadvantages. However desirable it may be that the powers of a nation should not be weakened by the existence in its midst of powerful bodies in a position to frustrate the attempts of its rulers to act with vigour and decision in a given way, and however much society may suffer from the absence of political cohesion, it is not conducive to the

[1] The correspondence between Trajan and the younger Pliny instructively illustrates this dependence. See Bury, *Student's Roman Empire*, 440–2.

[2] For the division of expenditure between the state treasuries and the towns see Humbert, *Essai sur les Finances*, i. 209, 389-401, 411–417.

[3] Roscher, § 156 ; also his *Ackerbau*, §§ 5 sq.

interest of the nation to concentrate all administrative authority in a single centre. The gains from centralisation may be great, but to obviate the evils that accompany it a wise decentralisation is also requisite. Having secured political unity, it becomes the task of the statesman to so distribute the functions of government as to obtain the best political and financial results. The earlier historical movement that has led to combination needs to be supplemented and corrected by the rational process of division of duties. All modern societies have to see whether their present institutions strike the mean in this respect, and if not, how they can best attain it.

§ 5. The relations of the administrative organs become more complex as States increase in size. A small society has no need of intermediate political forms between the lowest unit and the State, but in countries with the area and population of the great European powers or the United States something more is wanting. Between the 'parish' or 'township'—the 'primitive cell' of the political organism—and the central government there are found one or more bodies essentially subordinate to the latter, but of greater range and larger resources than the former. Thus France has the canton, arrondissement, and department; Prussia the district, the circle, and the province; England, the union and the county; the United States, the county and the state or 'commonwealth'; and in each nation a different class of duties is assigned in proportion to the size and importance of the particular body.

The complexities of local government and finance have in some countries been increased by the irregular and almost haphazard method of expansion adopted. Instead of following a definite and orderly plan, each special need has been met by a special creation. This natural but unfortunate method of procedure is characteristic of English and, in some degree, American legislation. Where a new local duty has been marked out, a new area with a separate board has been formed, ideas of uniformity or co-ordination

being almost ostentatiously disregarded. The outcome in England has been, according to Mr. Goschen's often-quoted phrase, 'a chaos as regards authorities, a chaos as regards rates, and a worse chaos than all as regards areas.'[1] Something similar is the case in a few American States. 'In many of our commonwealths,' says Professor Seligman, 'there are separate local taxes for almost every purpose of local expenditure. In New Jersey, *e.g.*, we find no less than forty such separate taxes.'[2] The reason for this confusion is only discoverable by considering the usual conception of local governing bodies; they were regarded rather as associations for a particular end than as delegations of the public power, and it is in fact true that the smaller subdivisions do approximate more closely to private groups in proportion as their sphere of action is reduced. The generally unsystematic character of English legislation also favoured this extreme multiplication of local functions arranged on no definite plan.

Political organisation, developed on perfectly logical principles, would offer a decided contrast to the multiplicity of arrangements just described. It would be symmetrical and convenient to a degree that no country—not even France—can lay claim to at present. In actual political life, perfectly adjusted plans of the kind are inapplicable. Constructive legislation is hindered by the nature of the materials that are at hand. The correct and well-fitted plan will not work by reason, first of all, of the varying circumstances of different districts. Rural areas are suited for a simple kind of local government that would utterly fail if applied to towns or cities. The latter require a more elaborate and careful system; new administrative problems are constantly arising;[3] their expenditure is sure to be much greater, and even if part of it be what is called

[1] *Local Taxation*, 190.

[2] *Finance Statistics of the American Commonwealths*, 108.

[3] The prominence that the question of municipal trading has assumed is a good illustration.

'productive,' and likely to afford counterbalancing receipts, there is still a greater amount of energy and toil required in working their finances, and special provisions are needed in order to guard against abuses.[1] In many countries, however, backward agricultural districts are often transformed in a few years into seats of manufactures and commerce, making alterations in the form of local government essential.[2] Some particular interests are also so important as to need special treatment. The management of harbours, river navigation, and drainage, or great public works created at the cost of the State, may have to be placed under bodies formed to represent the interests chiefly concerned, and they must be kept apart from the general system, and so far mar its completeness.[3]

The necessity for attending to geographical boundaries tends to prevent even an approximation to divisions with equal areas or population, and special local habits and customs act in the same direction. But the greatest check in this direction arises from constitutional restraints. Perfectly unified governments, such as those of France and England, are seemingly free from this defect. There is nothing in English law to prevent Parliament from abolishing the division into counties and parishes, and substituting a new one in its place. The whole machinery of municipal administration might at the same time be handed over to a central board with an official staff.[4] The federal countries—Germany, Switzerland, the United States—are differently situated. In their case the power of constitutional legislation is

[1] Rules limiting expenditure, and so raising a barrier against abuses, are in such cases very useful, and seem to be growing in favour both in the United Kingdom and the United States.

[2] The number of new towns that have sprung up in England, Germany, and above all in America, during the last fifty years, makes this point important.

[3] The Harbour and Dock Boards, very common in England, elected under special franchises and with power to levy tolls, are a good example.

[4] Every one knows that Parliament will do neither of the things mentioned in the text, but the limitations on its action are *moral*, not *legal*, and consist in the fear of exciting opposition on the part of the people, and in its own sentiments, *i.e.* they are external and internal. Cp. Dicey, *Law of the Constitution*, Lect. ii.

distributed in a more complex manner, with the intention and result of checking its frequent exercise. Such 'rigid' constitutions—as they have been happily called—give a permanence to particular local divisions that prevents the powers of administration being divided in accordance with theoretical conceptions. A Swiss Canton or American State holds a legal position essentially different from that of a County or Department. It is prior in order of time to the central government, towards whose creation it may be said to have contributed, and it is entitled to object to measures affecting its existence.[1] Whatever be the reasons in favour of this system—and we need not undervalue them—it is a fatal barrier to orderly and proportionate distribution of functions. Delaware and Rhode Island, insignificant both in population and area, hold the same place as the great States of New York, Pennsylvania, and Texas; Bern, with more than half a million of people, is only equal to Uri, with less than one-thirtieth of that number.

Difficulties of the kind just noticed are not in reality so serious as they at first appear. To begin with, the intractableness is found in one only of the minor groups or subdivisions; the others can be easily adjusted. Congress cannot, indeed, redistribute the areas of New York and New Jersey without the consent of both of those States, but either State can rearrange its counties and municipalities as it pleases; the important cities of New York and Brooklyn have been consolidated into greater New York by the legislature of the State. Therefore, within each State a reorganisation of local government is possible. Again, by taking extreme cases an unfair impression is produced. The average State or Canton (say Wisconsin or Freiburg) is a convenient body to interpose between the national government and the smaller local groups. There is,

[1] 'No new State shall be formed or erected within the jurisdiction of any other State, nor any State be formed by the junction of two or more States or parts of States, without the consent of the legislatures of the States concerned as well as of the Congress.' *Constitution of U.S.*, Art. iv. section 3. Cp. Art. 78 of the German Constitution for an analogous provision.

besides, a tendency towards adjustment between the habits of a people and its indigenous institutions. The Americans and Swiss have by usage become fitted for their particular systems, which therefore work with greater ease. The distribution of the several German States is more irregular, and illustrates, as noticed before, the powerful influence of historical conditions. The principal anomaly is due to the preponderance of Prussia, compared with the very small States that form part of the empire. The internal local government of Prussia is, however, based on a well-proportioned system.[1]

§ 6. Applying our results to the financial question of expenditure, and its proper division, we commence with the central government. Its claims to disburse the larger part of the total public revenue are unquestionably strong. It is the representative of the nation. Other bodies exist under it, and to relieve it of undue toil, but 'the State,' in the popular sense of the term, is *prima facie* the agent in charge of all public duties. It is at once clear that all general interests ought to belong to its province. What concerns the whole community may indeed, for other valid reasons, be delegated to localities, but the fact that a public function concerns all is a weighty reason for entrusting it to the central government. A smaller body, no matter how liberal its constitution may be, cannot take the same ground. Even an absolute ruler is more likely to regard the welfare of the whole society than the representative assembly of one part of the nation's territory, while the highest security for due attention is obtained by the representation of all districts in a national legislature. This attitude of the central government is partly the consequence of the wider view that it is almost compelled to take, but it is also partly due to the higher intelligence and skill that it has at its disposal. For tasks in which these elements are

[1] See the instructive articles on 'Local Government in Prussia,' by Professor Goodnow, *Pol. Science Quarterly*, iv. 648–666, and v. 124–158; and the same writer's *Administrative Law*, Bk. iii. ch. 7.

of importance, the superiority of the central administration is generally apparent. A third circumstance in many cases favours the centralisation of certain classes of state duties —those namely in which unity and co-ordination are required. Though division of labour is beneficial, its combination is no less so, and public duties that need combination will naturally be placed under a single control. It would be too much to assert that these conditions have completely determined the actual sphere of the national government in modern countries; it would be a gross exaggeration to say that they have done so consciously. There is, however, much truth in the doctrine that the actual forces which they describe have generally had a powerful effect.

The sphere of local agencies in directing expenditure can be indicated by reference to conditions strongly contrasting with those just described, which make it expedient to call into play the administrative energies of the smaller territorial bodies. As the central power guards the general interest, so do the representatives of localities best attend to their particular interests. 'That people manage their own affairs best' is not universally true, but it has sufficient truth to justify the entrusting of local matters to the several localities affected. A second case in which local is superior to central administration occurs wherever minute supervision is required. Central authorities, though possessed of superior skill and intelligence, often fail through the difficulty of regulating from a distance operations that need unfailing attention and watchfulness. It is to this circumstance that we must attribute the almost universal devolution of the smaller parts of economic administration, as it is to it that we probably owe the origin of the attempts at decentralisation on the part of the general government. Finally, it is expedient to place the charge of public duties in the hands of the smaller bodies, when diversity rather than unity is needed. Some of the forms of state action are not suitable for being conducted on a uniform pattern.

Special conditions and habits have to be taken into account, so that the very tendency to adopt different methods becomes a benefit instead of an injury. We thus reach the result, that if attention to the general welfare, the command of higher intelligence and skill, and the power of unity in action are advantages possessed by the central government, regard to local interests, attention to details, and possibilities of judicious variety in practice will be best secured by local management.

Like conditions help to determine the functions of the intermediate public organs. A county administration has the same superiority over a parochial one that the national one has over it, and it is inferior in the same respects. An American State holds a similar position in respect to the smaller local divisions. Its sphere of action has to be limited in both directions by reference to the general principles already noticed. When we come to such important divisions as the State of New York or the administrative county of London, restrictions on their functions are dictated rather by considerations of national unity than by defects of organisation. The position of the larger German States—Baden and Saxony, and still more Bavaria and Würtemberg—in the distribution of power can hardly be settled by reference to principle. It will rather depend on a compromise between their claims to complete self government and the need for greater unity of the empire.

§ 7. Taking up in order the different forms of public expenditure, we find it easy to understand the reasons for making the military and naval forces a national charge Security is the greatest general interest of a society ; the appliances and organisation necessary for successful defence tax severely the highest powers of human intelligence ; and unity of management is of great advantage in warfare. Consequently the cost of war and preparation for it always comes from the national budget. Germany and Switzerland still preserve some traces of the older independence of their component parts, but the German forces are in fact

completely under imperial control, and their cost is defrayed from imperial funds.[1] One of the most decisive marks of union between hitherto independent States is the formation of a common army.

The cost of Justice also seems most fitly to belong to the general expenditure. It figures in all national budgets, but some of the charge may be thrown on localities. In a Federal State the subordinate courts are usually reserved by the separate units, but the Judiciary of the union becomes a general charge. The reason of this division is plainly historical, and as there is no pressing necessity for complete unity in the judicial organisation, it is allowed to continue. The importance of distinguishing between federal and state law is a further ground for separating the central and local courts. Uniformity in law and in its administration is such a benefit to a society that, unless under special circumstances, it is advisable to place it in the hands of the national government. Efficiency, too, is increased by removing the judges from the distracting influence of local feeling that is sure to affect them when they are appointed and paid by the district in which they act.

Police, and the treatment of criminals, cannot be definitely assigned to either department. On the one hand, it is certainly advantageous to have these matters arranged on general principles. All members of the nation are interested in the preservation of internal order in every part of their country. No district should be allowed so to relax its prison administration as to offer inducements to a criminal class to congregate within it;[2] but on the other hand, the

[1] Bavaria and Würtemberg are the only States that keep an appearance of independence, but in war the allegiance of the Bavarian troops is due to the Emperor, and her contribution towards expenses is compulsory. In Switzerland, though part of the forces are cantonal, the first claim on their services belongs to the Federal Government, and the principal outlay is by it. In 1876 it was about six-sevenths of the whole.

[2] 'It would not be a matter personally indifferent to the rest of the country if any part of it became a nest of robbers or a focus of demoralisation, owing to the maladministration of its police; or if, through the bad regulations of its gaol, the punishment which the courts of justice intended to inflict on the

benefits in closer supervision and greater economy when the duty is entrusted to localities are a considerable set-off; besides, the principal interest of good order is found in the case of those resident in the district. A practical solution is generally discovered in a division of the duties, combined with regulations as to the distribution of the burdens imposed.

Administrative duties have also been divided, and though, in most countries, no attempt has been made to settle the partition on intelligible principles, usually in conformity to the guiding conditions indicated above. Where wide general interests, requiring a high degree of skill from those who control them, are involved, the central government has been the acting body. In smaller and more detailed matters the local governments have undertaken the task.

The relief of distress was primarily a local duty. During the development of the English Poor Law, previous to 1834, the whole system of management was left to the small unit of the parish, and though this arrangement led to much irregularity, it afforded examples of the best method of administration, which were utilised by the reformed system.[1] Local administration and charge do, however, give rise to difficulties; in particular the question of the domicile or 'settlement' of those relieved becomes a constant subject of dispute. 'The birthplace and dwelling of the foremost peer,' says Mr. McNeil-Caird, 'the birthplace and dwelling of Newton, Shakespeare, Milton, or Burns were never investigated with half the eagerness, or a tenth of the expense, that is freely spent as to the birth and residence of a pauper.'[2] The injustices attending the distribution of the cost are always perplexing, but local direction and

criminals confined therein (who might have come from, or committed their offences in, any other district) might be doubled in intensity, or lowered to practical immunity.' J. S. Mill, *Representative Government*, 116.

[1] See *Report* of the Commission of 1832, 232–260.

[2] *Local Government and Taxation*, Cobden Club Essays (3rd Series, 1875), 143.

management under central regulation presents, on the whole, the least objectionable method.

In dealing with education, it is at once obvious that elementary teaching has a closer relation to separate localities, resembling, in this respect, poor-relief. Particular circumstances so far affect it that there is reason for making it, at least in part, a local charge; but it is also a general interest affecting the well-being of the whole society, and requiring for its proper working a great amount of trained intelligence, which can be best supplied by the central government. The higher grades of education do not admit of the same degree of localisation. Universities in especial bear a distinctly national character, and are therefore, so far as they receive public aid, rightly a national charge. Other appliances for instruction and the promotion of culture are provided both from general and local sources, though it is hard to determine what should be the exact position of each in the matter.

Wherever the support of religion is a public function, it is met from the national budget, or at least by national endowments, the cases where local bodies pay for religious services being simply compensation for work done, as in the case of union chaplains, &c.

The principle of general or particular interest explains the division of the economic duties of the State. What affects the whole society is done by the central government; what is specially needed by a locality or minor division is usually done by it. Here, however, there are exceptions. Works too extensive for the resources of a district are undertaken by the central administration, or aid is given to the subordinate authorities that direct and manage them. In this department of expenditure the smaller bodies are more likely to become embarrassed than is the central state authority. Their available funds are not of such vast extent, and change more speedily in amount owing to their limited area. Local administration, besides, in reference to public works is more liable to suffer

from the private interests that affect all public ceremony.[1] The modern credit system, however, affords facilities for expenditure based on a pledge of the property of the district that will not be felt at once, but will prove a continuous charge. It is in respect of this so-called 'reproductive' outlay that the difficulties of local finance are at present most serious.

Finally, with regard to what we have called constitutional expenditure, the boundary line is plain and simple. Each part generally pays for its own outlay. Members of the central executive and legislature are paid from the central budget. The officials and subordinate legislators of states, cantons, or municipalities are paid from the budget with which they are connected. As an exception, the charge of all elections is sometimes a local one, but it is so on the ground that it is really a local interest.

§ 8. It thus appears that on a broad view, and with full allowance for the influence of previous history and special circumstances in each case, there is a tendency to distribute functions, and therefore expenditure, in accordance with the principles that we have seen in operation. Some additional reasons for particular forms of distribution may be noted here: they are really expansions of those already pointed out.

First, particular duties are often given to, or withheld from, local bodies on the ground that they are well or ill suited, as the case may be, to bring the cost of the service home to those who benefit by it. This, however, is merely an application of the principle that particular interests belong to those concerned in them, and a further reason for that policy. The division of control over outlay, so as to secure justice in the apportionment of the burden, can be realised in another way, viz. by a readjustment of receipts between the central and local governments. A further ground for limiting local duties is sometimes found in the existing division of general and local taxation.

[1] Bk. i. ch. 1, § 2.

Where, as in some countries, local revenues are rigidly restricted in amount, it is evidently impossible to place duties involving much extra cost on them. Here, too, the true explanation is found in the narrowness of the local interest that has led to the limitation on its taxing power, and it can be remedied, either by removing the restraint, or, as in recent English legislation, by a transfer of part of the general revenue. By dexterous use of the latter method it is possible to combine the great aim in expenditure—the maximum return for outlay with that in the collection of revenue—a just distribution of burdens.[1]

§ 9. Some further characteristics of local finance in relation to expenditure require attention. We have seen the classes of duties that local bodies deal with, and that they are mainly of an economic character, at least in so far that advantage and cost can be somewhat definitely measured. This feature suggests, as we saw, a comparison with private economic associations; and though the resemblance is closest in the industrial domain,[2] it also appears with regard to expenditure. There is, however, one essential difference. The private company is formed on a voluntary basis. No one is compelled to enter it against his will; a local governmental body has compulsory powers, and is therefore more particularly in need of being kept within bounds in its action, and of being compelled to act when circumstances require it. Some of the duties in its charge are general state tasks, delegated for motives of convenience. These it cannot be allowed to neglect. Otherwise provisions for poor relief, education, or police of the highest value might be rendered utterly useless by hostility on the part of the local administrators. In other cases, where the task is of purely local interest, as *e.g.* water-supply, a minority of the inhabitants may suffer from the ignorance or carelessness of the majority, when also there is ground for interference by the central power. Such cases make

[1] Cp. Bk. iii. ch. 6, § 7.

[2] As in the case of municipal gas or water works; Bk. ii. ch. 3.

supervision and regulation of the various divisions a necessity of good government. To insist on the discharge of certain functions, to prevent an undue extension of others, and, finally, to protect the interests of individuals against encroachments by local authorities, becomes an important state work.[1] An organisation connecting the local and central bodies is needed, and has been developed in most countries. The English Poor Law Board—becoming later on the Local Government Board—is a good example. So are the many Commissions in the American States ; while similar results are attained in another way by the bureaucratic systems of France, Germany, and Italy. The need of securing due discharge of duties imposed, avoidance of expenses in directions not allowed by law, and moderation in the exercise of expenditure, even on lawful objects, has brought about a system that shows in the clearest way how all expenditure, local as well as general, is really one, and has to be combined in order to judge correctly of the pressure of the State and its organisation on the national resources.

The value of this conception of the unity of state services in helping to form a more accurate idea of the amount of public expenditure will be better realised by reference to the following table :—

TABLE (000's omitted).

EXPENDITURE.

Country.	*Central.*	*Local.*	*Total.*	*Percentage of total expenditure by Local Government.*
	£	£	£	
France (1899).....	143,576	44,720	188,296	23·7[2]
Italy (1897-8)	67,689	31,088	98,776	31·3
United Kingdom (1898-9)	108,150	79,300	187,450	42·3
United States (1890).....	70,443	112,747	183,190	61·5

[1] Roscher classifies duties of local bodies as (*a*) State, (*b*) compulsory local, and (*c*) optional local. § 157. Cp. Wagner, i. 96 sq.

[2] The local expenditure is somewhat underrated owing to defective

NOTE.

Some writers on finance have included in their discussions an examination of the finance of 'State Confederations' (*Staatenbünde*) and also of Colonies,[1] but neither seems entitled to a distinct place. There is a decided difference between a federal State and a confederation of a group of States. The former is a true political unit, and one of the points of unity is financial; the latter can be resolved into its component parts, each with a separate financial system. The resources of a confederacy are always derivative, and are obtained from the separate States. The old German Bund (1815–1866) may be contrasted with the existing German Empire as effectively illustrating this essential distinction.

But though in general the line of division is a clear one, some difficulty occurs—as is so often the case in political and social inquiries—in respect to societies in a transitional condition. The American Confederation in the period 1776–89, and the Swiss Confederation, 1816–1848, may be taken as examples. In such instances we find a new financial organisation in course of development, the older bodies being gradually merged in a new and larger whole. The best method of treatment is to start from the consideration of the separate parts and show how they become effectively combined in the natural course of events.

The financial position of such a composite State as Austria-Hungary is another difficult question; but here, again, the parts take precedence of the combination, which is strictly dependent for its revenue on the contributions of its components. The revenue of Austria-Hungary is formed from expenditure by Austria or Hungary. A further consideration to be borne in mind is the determination of the amount of contribution on the basis of treaty or contract, which will presumably be calculated in proportion to the benefit received by each portion. The whole arrangement is therefore one of international rather than public law.

Like considerations are applicable to Colonial finance. It is perfectly correct to combine the central and local finance of the United Kingdom into a single whole. A similar attempt with the British, Canadian, and Indian

---

returns. According to the American Census of 1890, the distribution of expenditure amongst the different authorities was as follows:—

	$
National Government	352,218,614
States and Territories	77,105,911
Counties	114,575,401
Municipalities	232,988,592
Public Schools	139,065,537

County and municipal expenditure is partly estimated.

The Census Report of 1900 in its full form is not yet available.

[1] Stein, i. 64, 76–81. Wagner, i. 79, includes the first, but not the second kind of Colonial finance. For the latest treatment on the subject, see Flora, *Le Finanze degli Stati Composti.*

financial systems would be absurd.[1] The conditions of unity do not exist. The very conception of a financial system depends on the existence of the single State which has created it. Any departure from this fundamental principle must produce confusion.

---

[1] A good illustration is supplied by the Australian Colonies. Previous to 1901, Victoria and New South Wales were quite separate, and their financial systems could not be scientifically combined. Now they are parts of the Commonwealth of Australia, though it will be some time before the financial arrangements are duly adjusted. A confederation of the British Empire may afford another example on a grander scale.

CHAPTER VIII

SOME GENERAL QUESTIONS OF EXPENDITURE

§ 1. STATE outlay, like that of the individual, may be distinguished into normal or 'ordinary,' and abnormal or 'extraordinary.' These terms almost explain themselves, but may be thus contrasted. Normal expenditure is that which recurs at stated periods and in a regular manner; it is accordingly capable of being estimated and provided for. Extraordinary expenditure has to be made at indefinite times and for uncertain amounts, and it cannot be reckoned for with any approach to accuracy. The distinction is not always applied in the same way,[1] and indeed the boundary line is not to be quite sharply drawn. Most heads of outlay vary from time to time, and any increase may so far be regarded as extraordinary, the 'ordinary' charges being those that, like the English Civil List, are fixed for a long term. In practice, however, very close estimates can be made of probable expenditure, small increases in some directions being compensated by savings in others.[2] To use the distinction to the best advantage, we shall confine it to marking the difference between the usual expenditure and unanticipated extra demands, arising in most cases from fresh calls on the State. We should describe the usual

[1] For the different uses, see Wagner, i. 135 sq.; Cohn, §§ 157–9.

[2] The English budget estimate of expenditure for 1889–90 was £85,967,000; the expenditure for that year was £86,083,000; an error of less than one-seventh per cent. Supplementary estimates are, of course, excluded.

annual expenditure on military and naval forces, the cost of justice and education, as normal or 'ordinary.' The cost of a war, or expenditure for the relief of distress in a sudden emergency, is, on the other hand, plainly 'extraordinary' or abnormal. No French financier could have foreseen the burdens that the Franco-German war of 1870–1 would impose on his country; nor, though the probability of disturbance was recognised in the United States for some years before the Civil War, could there be any calculation of its expense.[1] Even after the outbreak of a war the difficulty of forecasting expenditure is very great. The first estimate by the Chancellor of the Exchequer for the expense of the South African War was £10,000,000, part of which would, he held, be recovered. Eighteen months later, he announced that the cost incurred up to that date reached £150,000,000. In like manner it is not open to the English Government to provide beforehand for Irish distress, or for Indian administrators to say whether their finances will be disturbed by famine. War and—in backward countries—distress approaching to famine are events that do recur, and though it is not possible to forecast their effects on public expenditure for short periods, they ought to be taken into account in the general financial scheme. The famine fund of the Indian Government was a recognition of the correctness of this principle, and though the cost of war does not admit of the same mode of treatment, it is sound policy to reduce liabilities in time of peace, so as to secure some relief in the extraordinary charge in the time of war.[2]

It thus appears that, by taking a sufficiently lengthy period into consideration, the separation between normal

[1] The direct cost of the war of 1870–1 to France has been estimated at £234,000,000. Giffen, *Essays in Finance* (1st Series), 1–55. That of the American Civil War at £1,800,000,000. Wells in *Cobden Club Essays* (2nd Series), 488. Mr. Bolles gives £1,238,000,000 as actually paid out up to 1879. *Financial History of U.S.*, 241 sq.

[2] 'The amount of revenue raised in time of peace ought to be greater than the expenses for a peace establishment, and the overplus applied to the discharge of debts contracted in former wars.' Hamilton, *National Debt*, 7; see Bk. v. ch. 7, § 4.

and abnormal outlay may be so attenuated as almost to disappear. The conception is a vague one. 'It indicates,' as Cohn remarks, 'an undeveloped stage of economic thought,'[1] to be replaced by the more careful estimation of the future. State economy expands both in bulk and duration. The expenditure of *e.g.* England under the Tudors was likely to show 'extraordinary,' *i.e.* unusual, elements in matters that are at present well within the prevision of the Chancellor of the Exchequer. When the outlay is measured by thousands, a variation in hundreds is serious; but when it reaches millions, changes of thousands are trifling, besides being balanced through savings in some other parts of expenditure. There is also in modern States a greater facility for foreseeing and, so to say, 'discounting' the future. The refined financial mechanism by which public borrowing is carried out enables 'extraordinary' expenditure for a short period to be transformed into 'ordinary' expenditure for a long one.

Still, the development just noted does not remove completely the dividing-line between the two classes of expenditure. We shall find later on[2] that both on financial and political grounds it is eminently desirable to have the estimates and results of national finance set forth fully and in unity at short intervals, usually in practice annually. But during such a period it must sometimes happen that the amount to be paid out of the National Exchequer will be much above the average, and it follows as a matter of course that the expenditure is then 'abnormal.' What modern finance can accomplish is to secure a more even distribution of the pressure.

Another point for consideration is found in the fact that what is at first extraordinary may soon become ordinary expenditure. At the outbreak of war the cost of the army and fleet will be greatly increased, giving rise to abnormal outlay, but after a time, say after the first year, a probable estimate of the expenses to be incurred in the prosecution

[1] § 157. [2] *Infra*, Bk. vi. ch. 3.

of the war will not be so difficult. The financial history of England affords several illustrations. During the century and a quarter from 1688 to 1815 there were the following war periods: 1688–1697, 1702–1713, 1718–1721, 1739–1748, 1756–1763, 1776–1783, 1793–1802, 1803–1815. At the commencement of each period expenditure was greatly increased, but when the state of hostility became a settled one, it was possible for, and therefore incumbent on, the Minister in charge of the finances to present the outlay on war as part of the ordinary expenditure. Under such conditions the charge for war became the normal charge of an abnormal period.

Abnormal expenditure also frequently occurs in a somewhat different way, as in the case of durable public works or other improvements. It may be a part of state policy to erect extensive public buildings; to carry out a system of fortifications, of railroads, or canals; to drain and plant waste lands; to promote colonisation, or to develop an industry that requires the aid of fixed capital. Innumerable examples of such forms of expenditure are found in connexion with local government: the acquisition of the industries engaged in supplying large towns with water and light will at once occur. Outlay of this kind is, in mercantile phraseology, 'chargeable to capital, not to revenue,' and is clearly abnormal. The method almost invariably adopted is to meet the abnormal outlay by an abnormal receipt, viz. borrowing; or, to put the point in another way, to turn the extraordinary expense of a given year into the ordinary one of interest on debt.[1]

Much ingenious argument has been advanced in favour of borrowing for all such extraordinary expenditure, on the ground that it is in substance a creation or investment of capital, which is an asset to be placed against the new

[1] The theory of public debts and borrowing is treated in Bk. v. chs. 5, 8. In local finance we shall see that borrowing is in such cases the only course open, as otherwise the funds could not be obtained, owing to the restraints on local taxing powers.

liability.[1] The plausibility of this doctrine in its extreme form arises from failing to notice the different effects that may follow from different forms of state expenditure.

§ 2. For understanding the point it is necessary to separate state outlay into 'productive' and 'unproductive,' using these terms in the sense given to them by Adam Smith.[2] The former does, in fact, secure a return in the shape of material goods possessing value, and it may be said that expenditure of this kind is admissible even by the aid of loans. The general category of productive expenditure will, however, be found to need further analysis. It is not at all difficult for the central and local governments to expend a great deal in obtaining articles that possess value but yet will not yield revenue. For instance, the many buildings existing in the United Kingdom for the meetings of legislative bodies, sovereign and subordinate —from the Houses of Parliament down to the smallest town-hall—are certainly embodiments of value, but do not, except in very rare cases, bring in a return. They are 'consumers' capital,' and their cost must be supplied from other sources. In contrast to the foregoing are those forms of wealth that return a revenue by their use as 'producers' capital.' Municipal gas and water works belong to this class; so do the Continental state railways. The policy of expenditure on such works is plainly to be judged, partly at least, as a question of investment. Public bodies may succeed in realising good value for their outlay. It is perhaps on the whole best to divide expenditure into 'economic' and 'non-economic' rather than into productive and non-productive; outlay for the purpose of securing future revenue being economic, while that which will not have this result is non-economic.[3] The expediency of economic outlay is really a question

[1] See on this point Bk. v. ch. 5. C. Dietzel appears to be the originator of the theory. He is followed by Stein and partly by Wagner.

[2] *Wealth of Nations*, Bk. ii. ch. 3.

[3] The term 'productive' has received such hard treatment, and is so closely connected with the idea of material wealth, that it seems, on the whole, better to use a more distinctive term.

closely connected with the formation of state property and the (so-called) private revenue, and has to be treated under that head.[1] Non-economic outlay includes the procuring of material goods that are not productive capital, as well as the cost of those public services that take no tangible form. It may be, and often is, more necessary than pure economic expenditure, but it cannot be regarded as a creation of capital. National security and honour, the promotion of culture and education, may be better than wealth, but they are not wealth, and their cost is so far a deduction from the stock or accumulated wealth of the society. They belong to consumption, not to production, and the outlay on them has to be limited by economic considerations. Thus this case is closely parallel to that of the individual, whose expenses, for enjoyment, general education, &c., reduce his economic resources, and have to be limited by the amount of his income.

Some expenditure, both of individuals and of public bodies, may prove to be indirectly productive. What a person spends on recreation may so improve his health, both physical and mental, as to make his labour more efficient. The State may likewise, by its maintenance of a powerful army and navy, or an active police, increase the production of wealth, and in practice all public expenditure has this amongst other aims in view.[2]

§ 3. Though public and private expenditure have so many points of resemblance, there is one very important difference. The individual's income is formed by the returns on his property and the reward of his exertions. Public income or revenue is to some extent composed of similar constituents, but in modern times it is mainly derived from contributions levied compulsorily on the members of the society: that is to say, state income or revenue is derivative, and is dependent on national income; local public revenue is in like manner derived from the revenue of the community in its locality.

[1] Bk. ii. ch. 3.

[2] *Supra*, Bk. i. ch. 6, § 1.

This connexion of public and national revenue has been recognised from the earliest days of finance: it is to it that we owe in great measure the commercial policy of Europe in the sixteenth and seventeenth centuries. The Physiocrats also accepted it, as Quesnay's famous maxim '*pauvres paysans, pauvre royaume; pauvre royaume, pauvre roi*' shows. It is an essential doctrine of modern theory, though there is not perfect agreement on the question whether it is on 'net' or 'gross' national revenue that state income depends.[1] There can be no doubt that a small nation, with little accumulated wealth, cannot adopt the same scale of outlay as a larger and wealthier one, and one of the rules of good finance is to observe moderation in the demands of the State on its citizens. Beyond this general precept no definite result has been reached. Some writers have suggested a percentage limit for state outlay. Justi regards 16 per cent. as the average, 25 per cent. as excessive. Hock states 15 per cent. as the upper limit. Leroy-Beaulieu, who confines his discussion to the amount of taxation, arranges the charge on national income for state ends in grades: 5 per cent. he thinks light, between 5 and 10 per cent. moderate, over the latter figure heavy, and when 15 to 16 per cent. is reached it is almost impossible to increase it.[2] Any attempt to settle once for all the proper proportion of public expenditure to national income is necessarily vitiated by the different elements to be taken into account; such as (1) the purpose of the outlay; if it has an economic end a larger amount may be taken, since it is expected to yield a direct return, and even if not for economic ends, no decision can be made until the urgency of the want is known. A nation engaged in a conflict perhaps involving its national existence is justified in expenditure that would in ordinary times be imprudent. (2) The amount

[1] Schaffle and Schmoller have both suggested that 'net income' is not the only source of public revenue. Cp. Bk. iii. ch. 2, §§ 6, 7.

[2] For Justi see Roscher, *Geschichte*, 463. See also Hock, 35. Leroy-Beaulieu, i. 127 sq., esp. 133.

of the national income is also a factor to be considered. Expenditure requiring 10 per cent. of the annual income of India would be much more burdensome than if 30 per cent. were to be required in England or the United States. (3) The distribution and the forms of wealth, though less in importance, have some effect on spending power. The bounds of outlay in any given case can only be ascertained by trial, though it is plain that the agreement of the writers referred to above supports the belief that 15 per cent. of the national income is too large an amount to appropriate for state objects, unless in very exceptional cases.

§ 4. Other methods of measuring the proper amount of state expenditure are still more doubtful. We might take the proportion to area as a guide, were it not for the fact that the extreme differences in the value of land in different countries, as also the varying proportions that other forms of wealth bear to land, make this test fallacious. The amount of accumulated wealth, as estimated in modern statistical inquiries,[1] might be used, but we shall find that income (not property) is the fund out of which in ordinary cases expenditure has to be met, and the relation of income to property varies. A very commonly used index is the charge per head of population, though for this purpose it is far inferior even to the amount of property. An attempt to measure the comparative pressure caused by expenditure in India and in the Australasian Colonies, based on taking the charge per head, would give the astonishing result that it was about nineteen-fold heavier in the latter.[2]

Such considerations lead to the belief—which indeed ought to be obvious—that there is no mechanical mode of judging the sufficiency or the legitimacy of public expenditure, a belief that is strengthened by remembering

[1] Such as those of Sir R. Giffen De Foville, and Pantaleoni, for England, France, and Italy respectively.

[2] *Victorian Year Book*, 1887–8, i. 203, where a table of comparative taxation is given. In India and Australasia the proportion of tax to non-tax revenue is almost the same (40 per cent.), and the rate per head in India for 1885–6 was 3*s*., while averaged over the Australasian Colonies it was £2 17*s*.

that local expenditure must be added to that of the central government before the full pressure can be known, and that a series of complicated calculations is needed to apportion the combined charges over the several districts.

Fortunately the question of expenditure in all its forms does not present itself as a single problem. It would be quite hopeless to attempt to prepare a budget of outlay for any country without the aid of the material collected during previous experience. The great mass of expenditure is taken as settled, and it is only the particular changes for each year that have to be weighed in order to estimate their probable advantage. This method of treatment simplifies the issues very much. In the language of modern economists, it is 'final' rather than 'total' expenditure that needs the financier's attention.[1]

§ 5. The usual form that deliberation has to take is that of considering the advisability of increased expenditure. Theoretically it is of course equally possible to debate the benefits of retrenchment, but in nearly all modern States outlay is steadily increasing. The older doctrines of economy and frugality have disappeared, and in nearly every direction proposals for new exertions on the part of the State are put forward.[2]

First as to the facts: we may take a few typical examples. English expenditure in 1833 was 48¾ millions, in 1898–9 it was over 108 millions, or an increase of nearly 60 millions. But as 1833 marks the lowest point of English general expenditure, it will be fairer to take another set of examples given by Mr. Gladstone.

'The gross expenditure of the State was in 1842–3

[1] Thus in framing the English budget for 1894 the principal points for consideration were: (1) the propriety of increasing the naval estimates beyond the amount required in the preceding year; and, should extra expenditure be decided on, (2) its legitimate amount, which was held to be £3,126,000 out of £95,458,000.

[2] During the Parliamentary Sessions 1880–2, out of 576 financial proposals, 556 were for increase of expenditure, only 20 for reduction.

£55,223,000, and the local expenditure in the three kingdoms was £13,224,000, making a total in round numbers of £68,500,000. In 1853–4 the total state expenditure was £55,769,000, or very nearly the same amount as in 1842–3, and the local expenditure £15,819,000; making together in round numbers £71,500,000, instead of the £68,500,000 which was the amount in 1842-3. In the year 1859–60 the gross state expenditure had grown from £55,769,000, which it was in 1853, to £70,123,000. The local expenditure, no doubt actuated by a spirit of honourable rivalry, had increased in the same period from £15,819,000, which it was in 1853, to at least £17,458,000, and probably something more; the total expenditure for the year 1859–60 thus reached £87,697,000 [?]. Accordingly it appears that in the eleven years from 1842-3 to 1853–4 the expenditure of the country under the two comprehensive heads which I have mentioned increased at the rate of 4½ per cent., nearly the whole of the increase being local; while in the six years which have elapsed between 1853 and 1859 it became much more mercurial, and increased at the rate of 22½ per cent., by far the larger part and greater rate of increase being now imperial.'[1]

To complete the illustration, we may state that for the year 1879–80 the national expenditure had risen to £82,184,000 (or, deducting the imperial contributions for local purposes, which came to £3,396,000, £78,788,000), and the local expenditure to £61,174,000, making a total of £139,962,000, *e.g.* an increase over 1859–60 of almost 60 per cent.; that in 1889–90 the national expenditure was £86,083,000, and the local expenditure £67,120,000, giving a total outlay of £153,203,000 (or, deducting imperial contributions to the amount of £2,470,000, £150,733,000), being an increase of 82¼ millions over the expenditure of 1842–3, *i.e.* 120 per cent.; and finally, as already shown, that in 1898–9 the national expenditure was £108,150,000 and

[1] Budget Speech of 1860 in *Financial Statements*, 119.

the local £79,300,000, *i.e.*, a total of £187,450,000, or an increase of 25 per cent. over the expenditure of 1889–90.

France presents a similar movement. In 1820 the general expenditure was 906 million francs, by 1860 it had reached 2,084 million francs, or much over double; more precisely, 130 per cent. The expenditure for 1899 exceeded 3,589 million francs, or a growth since 1860 of over 72 per cent.[1]

The Italian expenditure of 1861 was 812 million lire: the estimate for 1901–2 is 1,728 million lire, an increase of 916 million lire, giving a growth in 40 years of 112 per cent.

The Prussian budget in 1849 was 282 million marks; in 1865 it had grown to nearly 507 million marks. Since the formation of the North German Confederation (1866) and the German Empire (1871) the increase has continued, the actual expenditure in 1889–90 was 1,831 million marks, and the estimates for 1902–3, 2,350 million marks. The Prussian Budget for 1901 is 2,614 million marks.[2]

The smaller German States exhibit like features. Bavaria spent 32 million marks in 1819–20; the expenditure for 1889 was 260 million marks, and the estimated expenditure for 1893 came to 306 million marks.

In Austria, Russia, and even in small States like Belgium, we find the same general tendency towards increased outlay. In the last-mentioned country, whose administration has been well conducted, the expenditure in 1835 was 87 million francs; for 1890 it was 417 million francs, making almost a five-fold increase. For 1900 the expenditure was estimated at 451 million francs.

So well established is the general fact of increasing outlay—and whoever doubts it need only run over the examples just given—that even conservative writers on finance, such as Roscher and Umpfenbach, lay it down as a general law

[1] See Léon Say, *Les Finances de la France*, iii. 1–31, for an admirable statement and criticism of this movement.

[2] There are, however, items of expenses and receipt between the Empire and Prussia which reduce each amount in 1902–3 by 348 million marks.

of progress ;[1] and they explain it by reference to the increasing demands made by society on the modern State. 'What judgment should we pass,' asks the former, 'on a government that, after the manner of the Middle Ages, did not trouble itself about the health, mental training, maintenance, or enriching of the people?' And so far there is no doubt that the intensifying of state duties is one cause of the almost universal increase. In previous chapters we have seen how the cost of defence, of administration, and the minor needs of civilisation have gone to swell the growing totals of modern budgets, and in each case special causes have appeared that went far to explain the final result.

Before collecting these, it may be well to correct to some extent the impression that increasing figures of outlay are apt to produce. Leroy-Beaulieu remarks[2] that one cause of the general increase is to be found in the depreciation of the precious metals. As expenditure is estimated in terms of money, any change in the value of the circulating medium should be taken into account, and the application of some test as to the reduced purchasing power of money would considerably alter the figures for the earlier part of the period that we have taken, *i.e.* from 1820 to 1870, but for the last thirty years the correction would act in the other direction. Increases in outlay since 1873 would certainly mean more than the amount as measured in money, so that we cannot place much stress on this part of the explanation of increase. Another element is, however, important. In most countries population is growing, and national income grows with it ; and in the exceptional cases where, as in France, population is stationary, income is increasing. It is not, therefore, certain that the proportion of public outlay to national income has become greater. Moreover—and this is the most important consideration—the extension of the economic activity of the State in certain directions has been accompanied by a

[1] Roscher, § 110; Umpfenbach, 38. [2] ii. 159.

passage of special industries from private to public management. As a necessary consequence, public expenditure and income are both increased without the real pressure on the people becoming greater. It may be that in this tendency there lies, in Roscher's phrase, '*ein communistischer Zug*,' and it is plain that the transfer in this manner of all industries means the establishment of socialism pure and simple. But apart from its economic reactions, a writer on finance is not entitled to absolutely condemn this movement. His duty is, however, to point out that comparison between the expenditure of a State with large industrial enterprises in its charge and one without them is illegitimate unless due correction is made. To take a simple illustration, it is plain that if the State purchased the English railways, and the accounts entered into the national budget (as they should), both expenditure and income would be largely increased. This has actually happened in Prussia, and explains a large part of the increased outlay in that country.[1]

Notwithstanding these extenuations, there has been, we believe, an increase in expenditure that is not balanced by receipts from the property of the State, and this larger outlay may be attributed to the following causes :—

(1) The cost of war and preparation for war. We need not repeat the details already given on this subject,[2] but we ought to emphasise the general fact. The annual military and naval expenditure of Europe approaches £300,000,000, and the disturbance to industry, the apprehension of hostilities, and above all the interest on debts incurred for the most part for the purpose of war, considerably increase the burden.[3] As if to enable us to judge of its effects, a test case has been provided in the condition of the United

[1] The estimated expenditure on the Prussian State Railways in 1902–3 is 883 million marks, besides the part of the total debt due to their purchase. The receipts, however, are estimated at 1,416 million marks.

[2] *Supra*, Bk. i. ch. 2.

[3] Neymark, *Les Dettes Publiques*, 89.

States, which further shows that it is not war, but the necessity of constant readiness for it, that affects most injuriously the economic interests of nations.[1]

(2) A second cause is to be found in the extension of administrative action. To maintain a large staff of competent officials considerable outlay is needed, much of it necessarily wasteful. It may be that a great deal of official work does with advantage to society what men are too busy or too careless to do for themselves. Perhaps also it checks some moral and social evils, but, financially speaking, it is undoubtedly costly, and if the end could be otherwise gained it would be an economic benefit.

To these causes many would add a third—the progress of democracy.[2] It is argued that a widely extended suffrage lowers the standard of legislatures, and that under the influence of socialistic ideas the expenses of the State are increased. There is probably some truth in this doctrine. The 'new radicalism' is not desirous of economy in expenditure,[3] and it may be freely conceded that 'democratic finance' is remarkable for its disregard of principles and its utter incapacity to measure financial forces; but on the whole it cannot be said that Russian finance, which is certainly not democratic, is much superior in these respects. Nor is it plain that English finance before the Reform Act of 1832 was worthy of commendation. The socialistic element which has an injurious effect on finance is not an essential part of modern democracy. The technical administration of revenue and expenditure is also likely to suffer while under the control of an untrained democracy. But allowing all this, the real enemy

[1] The policy of expansion adopted by the United States since the war with Spain will almost certainly bring them under the influences that have affected the finances of European States.

[2] Leroy-Beaulieu, ii. 169 sq.

[3] The contrast between the doctrines of *The Radical Programme* (ch. 8, 'Taxation and Finance') and those of Cobden, Bright, and George Grote is very extreme.

of sound finance is ignorance on the part both of rulers and ruled, and this is unfortunately too common under all forms of government.

§ 6. Any discussion of public expenditure that neglected to notice its influence on national and social economy would be incomplete. The State, through its central and local organs, is by far the greatest purchaser of goods and employer of services: it can in this way powerfully influence prices and wages, and through that influence affect the distribution of wealth. The sum of £150,000,000 annually disbursed (after allowing for the amount that goes as interest on loans, which operate on the money market) must both by its great amount and its changed direction alter the structure of the British national industries. Demand for commodities determines the direction that production will take, and consequently the form of labour in many cases depends on the policy of the State; so also do the rates of remuneration and the conditions of employment.[1] The economic systems of Germany and the United States owe their different features largely to the special direction of state activity in each country. The technical arrangements for the supply of commodities for public requirements are a serious consideration for administrators, owing to their ulterior effects. Government manufacture is liable to the evils of expense and inferiority in quality of products, but the alternative method of purchase in the open market, necessarily carried out through agents, is not free from similar evils. In particular, the result of giving contracts at the lowest tender has been vehemently assailed by reformers as tending to lower wages.[2] The direct employment of services or labour by the State gives rise to further complications. Hiring on the ordinary system and at the market rate is impossible in the case of the higher officials, while for

[1] Hermann, *Staatswirthschaftliche Untersuchungen* (2nd ed.), 465, indicates this very clearly.

[2] C. Kingsley, *Cheap Clothes and Nasty.*

military and naval services special conditions of engagement are needed. The great extent and variety of the general Civil Service make the determination of its proper remuneration a question of much difficulty. To avoid the political evils that short tenure—as in the American system—causes, its members ought to be permanently employed. Permanence in state service soon affects private employers, who will have to give either like security of tenure or better pay.[1] In every part of national life this influence of state expenditure is felt, and is becoming greater.[2]

The great and increasing importance of state outlay does not, however, afford a presumption that the movement is advantageous. The current of modern sentiment runs as strongly at present in favour of state action as it did fifty years ago against it, but neither tendency can be its own justification; both have to be judged on the grounds of reason and experience. Some popular arguments for state expenditure may be at once dismissed. Perhaps the crudest is that which regards the State as affording employment, and imagines that if war and the other conditions which call for state services were to cease, there would be no field for the labour of those now employed as soldiers, policemen, and officials. This obvious fallacy arises from entirely overlooking the previous existence in private hands of the funds collected by the State as its income, and which would afford like employment, but on other lines: the best practical refutation is, however, found in the ease with which the enormous expenditure of the United States during the Civil War was reduced at its conclusion, and the military forces absorbed in various industrial employments.[3] Expenditure of itself

[1] On this point cp. Prof. Foxwell's article in *Claims of Labour*, 254. For further observation of state dealings with labour, see Bk. ii. ch. 3, § 20.

[2] The belief that the State should be a model employer is rapidly gaining ground, as the partial adoption of the eight-hour day and the acceptance of the Trade Union rate of wages show.

[3] Wells in *Cobden Club Essays* (2nd Series), 491. Cp. Adam Smith's

is plainly not a good; it has to be judged by its object, *i.e.* by the benefits obtained in return for the sacrifices made. By taking this view we avoid the opposite fallacy that all state outlay is bad, or at all events that the less the expenditure the better. This doctrine, though accepted by Say and Ricardo,[1] is palpably incorrect, since it takes no account of one of the two factors in the problem. It is not true that the cheapest article is the best, nor is 'the cheapest State' the most serviceable. That state organisation is the best and really the cheapest which, all elements of the question being taken into account, gives the greatest amount of benefit to its citizens and provides best for the future progress of the nation.

APPENDIX.

On the Classification and Guiding Maxims of Public Expenditure.

The rapid development of financial study in recent years has led to a careful examination of the more backward divisions of the subject, in order to bring them into scientific form. The theory of state expenditure has naturally attracted a large part of this fresh energy. The undue neglect of the earlier English and French writers[2] has been replaced by rather elaborate critical discussion. But it is nevertheless true that the difficulties of the question have not by any means been removed. No one has as yet propounded a system of arrangement and a body of rules applicable to public expenditure which could claim to be of the same character and fundamental importance as those established for public revenue, and particularly for taxation. This failure is undoubtedly due to the peculiarities of the subject-matter, and is closely paralleled by, if not in a sense identical with, the case of the theory of consumption in Economics, as contrasted with that of production or distribution.

There is, however, some advantage to be obtained by considering the suggestions put forward by the able writers who have endeavoured to throw further light on the matter.

---

remarks on the absorption of 'more than a hundred thousand soldiers and seamen,' disbanded at the close of the Seven Years' War, in the ranks of industry. *Wealth of Nations*, 196.

[1] 'The golden maxim of M. Say, "that the very best of all plans of finance is to spend little, and the best of all taxes is that which is the least in amount.' Ricardo, *Works*, 145.

[2] See *Introduction*, ch. i. § 2.

First, we may notice the ingenious development of a conception, presented in a less elaborate form by Cohn, which appears in Professor Plehn's text-book.[1] This system groups the several kinds of expenditure with reference to the benefit that they confer. From the great class of expenditure which confers 'a common benefit on all citizens' there is a transition through the intermediate forms of outlay that (1) are special, but treated as common, and (2) confer both special and common benefit to that class which confers 'only a special benefit on individuals.' There are thus four sections or heads of expenditure, each of which makes a separate category, and it is claimed that on this basis a satisfactory—and the only logical—classification can be established.[2]

At the first glance the arrangement appears to be convenient, but even a cursory study suffices to bring out its defects. Perhaps the most obvious is the immense difficulty of assigning the various items of outlay to the prescribed categories. May it not be truly said that all expenditure is for the public and general interest? Otherwise it should not exist. Again, it is impossible to exclude the element of special advantage, even in the case of the first class. There are surpluses of utility accruing to some individuals from the expenditure for national defence or internal security. Thus the four classes may be reduced to one—the third in order.[3]

Still more serious is the fact that the allotment will vary according to the views of the arranger. Expenditure that one writer would put under a particular head will be assigned a different place by another. The classification —to state the point definitely—rests on a *subjective* rather than an *objective* basis. This would seem, of itself, enough to condemn it as a scientific solution of the problem. Prof. Plehn, indeed, in his treatment of the contents of the different classes, supplies examples which support this criticism. Thus, *e.g.* pensions as the recognition of service belong to class one, but when they are improperly bestowed they come under class two. How hopeless it would be to apply such a test the history of the English Pension List proves.[4] In truth, the test of graduated benefit is as unsatisfactory as one of graduated disutility would be for taxation.

Another theory is given in the work of Prof. Adams, in which the functions of the State are regarded as, after due analysis, affording a clue to the law of public expenditure. Governmental functions may be analysed into three classes—protective, commercial, and developmental. This classification also permits the framing of general laws as to the relative movement of the different groups. The cost of the protective function will decline, while that of the commercial one will probably, and that of the developmental one will certainly, increase with the progress of society.[5]

In this case also the difficulty of determining the proper head to which the

---

[1] Plehn, *Public Finance*, Part i. [2] Cohn, §§ 79–91; Plehn, 28–32.

[3] Prof. Nicholson puts this criticism most effectively. *Principles*, iii. 373.

[4] Even the annual pension grant of £1,200 for literary services has been the object of keen criticism, and in some cases the grants have been quite undeserved.

[5] Adams, *Finance*, Part i.

several concrete items of expense are to be assigned is encountered. There is no doubt that what some writers would describe as protective outlay others would call developmental. J. S. Mill showed long ago that there is no clear-cut line between the institutions and qualities that conduce to maintain order and those that promote progress,[1] and in the same way expenditure for protection helps development. Commercial expenditure, again, is justifiable only as contributing to present well-being or future progress.[2] An equally unsatisfactory feature of Prof. Adams' discussion is found in the laws of movement which he formulates for the several classes. To lay down dogmatically that protective expenditure declines in the progress of society is hardly warranted by facts. If any proposition can be confidently laid down respecting the course of expenditure in the near future, it is that military and naval expenditure will increase more than in proportion to other outlay—a statement that will probably be as true of the United States as of the great European powers. Prof. Adams', like Prof. Plehn's, classification fails to present the characteristics of a grouping, logical and in accordance with fact.

More scientific than either of the preceding attempts is the treatment of public expenditure adopted by Prof. Nicholson in his recent treatise.[3] After dwelling on the fact that expenditure must be regarded as co-ordinate with revenue, he classifies the forms of expenditure by reference to amount of revenue obtained in return for the services rendered. Thus the following classes may be distinguished: (1) expenditure without any direct return of revenue; (2) expenditure indirectly beneficial to revenue; (3) expenditure with partial direct return; (4) expenditure with full return or surplus profit.

Under this system the greater part of expenditure in every given State can be easily and conveniently grouped, but the difficulty remains that the dividing line is not always clearly marked, *e.g.* there may be doubt as to the inclusion of a particular item under head (1) or (2). Still more important is the question whether the classification is one which brings out the really essential differences in different kinds of expenditure and places these separate groups in their proper relation. It must never be forgotten that public expenditure is one division of the social consumption or using of wealth, and has, therefore, to be treated on the same principles as other forms of consumption. But it would hardly be allowable to classify the forms of private consumption by reference to the amount of income obtained in connexion with each. We could not get beyond the broad division into 'productive' and 'unproductive' consumption, which is not very illuminating as to the real character of the many sections of private outlay.

In truth, the forms of public expenditure are determined by the various needs of the State, and thus it appears that the consideration of these several wants in their concrete manifestation is, so far as inquiry has yet gone, the most convenient and instructive way of discussing this class of financial problems. No ingenuity of analysis can remove the subject of public finance

---

[1] Mill, *Representative Government*, ch. 2.

[2] For further criticism on this point see the reviews of Adams' work by Prof. Seligman (*Pol. Science Quarterly*, xiv. 134–5); and the present writer (*Economic Journal*, ix. 435).

[3] *Principles of Pol. Economy*, III. chs. 15, 16.

from the domain of Political Science, which, in turn, takes its starting point from the institutions and activities of the State.

Similar difficulties beset the framing of general canons of expenditure. Beyond the broad rule of aiming at the maximum result, it is not easy to reach any important conclusions by the deductive method. Nor does it seem probable that the canons of taxation can, as Prof. Nicholson believes, be employed as a guide in developing equally fundamental maxims for expenditure. There are, no doubt, certain common principles running through the whole public economy, as the laws of Supply and Demand affect most economic questions. In respect to expenditure there is, however, the influence of the needs of the society, which are in a sense extra-financial. This is the element of truth contained in the view of Leroy-Beaulieu and others, who refuse to include the question of expenditure in their treatment of finance.[1]

If scientific principles of expenditure are developed in the future, it will be by (*a*) the use of the marginal doctrine applied to the last increments of outlay in each particular direction,[2] and (*b*) the more critical examination of the actual processes by which the public economy is carried on. At all events, a long time must elapse before any rules claiming the authority that the Smithian canons of taxation have acquired can be elaborated.

---

[1] *Introduction*, ch. i. § 2.

[2] *Supra*, Bk. i. ch. 8, § 4.

BOOK II

PUBLIC REVENUE

THE ECONOMIC OR QUASI-PRIVATE RECEIPTS

CHAPTER I

THE FORMS AND CLASSIFICATION OF PUBLIC REVENUE

§ 1. A SYSTEM of public expenditure such as has been examined in the preceding book requires as its necessary basis a corresponding public revenue. State economy is in nowise exempt from that condition of all private economies which makes it essential to provide that consumption shall be balanced by production, and that effort must be put forth in order to procure satisfaction. In respect to the public power there is a wider field, but no change in the nature of things; the correlation of exertion and enjoyment holds here as elsewhere, and if temporarily disturbed is certain to be sooner or later re-established. All financial systems are in fact compelled to recognise the relation, though political exigencies may sometimes make it inconvenient to adopt a line of conduct completely in accordance with that recognition. Every Parliamentary Government has arrangements for raising funds as well as for granting supplies. In England the Committee of Ways and Means is parallel to the Committee of Supply,[1] as in the United States the small House Committee on Ways and Means is to the Committee on 'Appropriations.' The raising of revenue has to be formally separated from the more agreeable occupation of applying it for the public requirements.

[1] Though each is simply the House of Commons sitting under a special name.

Public revenue being thus the counterpart or obverse of expenditure, it becomes our duty to consider its forms and sources, and to see how far they admit of logical grouping and arrangement.

§ 2. This, like most financial questions, needs to be studied at first from the historical side. The early tribe shows us expenditure and revenue in combination; the services and commodities required for public use are directly levied and applied to the particular end.[1] When once this primitive stage is passed, revenue as distinct from expenditure emerges, and its collection and administration become matters of vital concern to the growing state organisation. It is true that for a long time contributions of goods are levied in kind, but their employment is more complicated, and involves redistribution of the different forms of wealth obtained by the State. With the introduction of money, the divorce between the revenue collected and the expenditure undertaken is finally established, since public agents can directly buy what they need for the public service, while the revenue is brought in under the form of the general medium of exchange. What strikes the observer most forcibly in contemplating this development is the extreme variety of the forms of revenue or state receipts. Dues levied on land, on goods of all kinds, on the performance of different acts, in addition to the several kinds of individual revenue, are enjoyed by the State. The Egyptian revenues under the Ptolemies were of the most varied kinds. The Roman finances received contributions from very many and diverse sources, and so did the Exchequers of mediæval sovereigns. When we run over the long lists that appear in legal and historical works treating of this side of mediæval law and economy, the greatest difficulty is to reduce them to some manageable form.[2] This complexity seems to have puzzled

[1] *Supra*, Bk. i. ch. 1, § 7.

[2] Thus Blackstone (i. 281–337) gives twenty-one different rights as composing the 'ordinary' revenue of the King, from which enumeration taxes are excluded. Cibrario describes twenty-four heads of revenue in mediæval Italy,

the earliest scientific students of finance. Bodin, as noticed before, arranged the sources of revenue under seven heads, but Klock, who fairly represents the German views of the seventeenth century, gives a far more extensive list. The 'chamber science' writers were more successful in grouping the forms of revenue under (1) those from the domain of the sovereign, (2) the so-called '*regalia*' or prerogative rights, and (3) taxes. In Adam Smith's hands the double aspect of the State became the basis of classification. Regarded as an artificial personality, or (in the language of modern jurisprudence) 'juristic person,' it might hold property and engage in trade. Revenue obtained in such ways 'peculiarly belonged to the sovereign.' It was his quasi-private income. In another aspect, as sovereign or supreme power he was able to impose charges on the revenues of his subjects, and these contributions or 'taxes' formed the second group of state receipts. The simplicity and clearness of this classification commended itself to English and French writers, who have almost universally adopted it. The greater political development of France and England, by making taxation the most important part of the state income, favoured its acceptance. The remains of the feudal system were more numerous in Germany, and its methods of finance in particular, with all their variety and confusion, were slow in disappearing from that country. Consequently German *Finanzwissenschaft* aimed at so arranging the forms of revenue as to give harmony and consistency to the existing systems. The '*regalia*' or prerogatives were always regarded with particular attention, and it was sought to place them alongside of taxation as a head of revenue.

Rau is in great measure responsible for another addition to the main groups, viz. that of 'fees' (*Gebühren*).[1] He

Economia Politica del medio aevo, Lib. iii. cap. 6. For the diverse Egyptian revenues, see Wilcken, *Griechische Ostraka*.

[1] Justi and Sonnenfels both speak of 'accidental revenue' (*Zufällige Einkünfte*), but they can hardly be credited with a theory of 'fees' as distinct from 'taxes.'

noticed that in many cases public institutions gave special benefits for which they charged an equivalent; *e.g.* in law proceedings fees were asked from the litigants. It was natural to regard this class of objects, denoted by a special name (*Gebuhr*), as a separate and independent form of revenue, giving as a final result that state receipts were distributed under four heads: (1) Private industry of State, (2) Prerogative rights, (3) Fees, (4) Taxes. On this classification of public revenues most of the controversies as to arrangement in German financial works turn. It is too plain for dispute that the first and fourth of the above-mentioned heads must be kept apart, but in the endeavour to bring the two intermediate divisions into some form of combination with them, great difference of opinion is to be found. Some writers oppose 'Taxes' to the three other forms of revenue, which are joined under some more general term.[1] Others place Taxes and 'Fees' under one head, and oppose them to the 'quasi-private income' and prerogative dues, or with greater wisdom eliminate the latter from the division altogether.[2] There is even a decided tendency in the latest inquirers to come back by a somewhat devious route to the plainer position of Adam Smith, and to recognise only the two great divisions of state revenue into (1) quasi-private and (2) public, though distinguishing, as he has done, the various cases of extra payment for special services.[3] A detailed examination of the many points raised in the controversy on this subject of classification would lead us too far, but some of the results are too important to be altogether passed over, and must therefore be briefly noted.

[1] This is the course followed by Stein and Roscher; the former (i. 138 sq.) speaks of 'economic' income; the latter of 'whole or half private economic State receipts.' Bk. i. chs. 4, 5 (§§ 18–24).

[2] Umpfenbach, who substitutes the term 'Fiscal prerogative rights' (*Vorrechte*) for '*regalia*,' takes the former course: 78; Wagner, i. 487 sq., ii. 33, the latter. In recent discussion, 'contributions' (*Beiträge*) have been brought in as an additional section of revenue by some writers.

[3] This is the case with regard to Cohn (see *e.g.* § 107), who declines to discuss the question of state property, as being economic rather than financial.

§ 3. First, it is abundantly established that much of the difficulty of classification arises from the historical peculiarities of different countries. The whole doctrine of the *regalia* is an instance in point. It was the result of attempting to apply the special German forms of revenue, due to the slow development of the financial system, as general categories suited for all times and places. A particular kind of state rights was opposed to the general state right to raise funds, of which it was but one part.

A second result of the discussions on arrangement is that the many and varied shapes of public revenue do not always admit of sharp and clear-cut divisions. Just as in economics we pass by a series of steps from the purest form of productive capital to what could not by any straining of terms be regarded as such, so do we find many transitional forms between what is the State's private income and what it gains by pure taxation. The attempt to create a co-ordinate class composed of 'fees' parallel to taxes is the outcome of this circumstance, as also of the want of analytic power in the originator of the classification. If Rau had recognised the frequent combination of the double elements of state industry and taxation under the apparently simple and independent form of revenue, he would have aimed at separating and assigning to its proper place each of those elements, while he duly noted the intermediate forms that presented most difficulty. The department of fees (*Gebühren*) touches at one end the quasi-private income of the State, and at the other, as in the case of 'taxes on commerce,' the field of taxation, but it has no central point possessing well-assigned and definite features, and enabling us to give a definition that is at once rational and useful in practice.

A third conclusion is also warranted, viz. that it is easy to overrate the value of precise and rigid classification. We need not deny that a good and natural grouping (*i.e.* a grouping in accordance with the real affinities of the objects dealt with) is very helpful both for exposition and

investigation. By its aid, features of resemblance and of contrast are most easily perceived, and new and hitherto neglected relations are often suggested; but notwithstanding these undeniable advantages, the most essential matter after all is to give adequate and proper treatment to the material of study, and even with a somewhat faulty arrangement this end can be attained. And not only so; the merits of any particular classification depend partly on the end in view. In a purely historical inquiry the class of *regalia* is entitled to a prominence to which it has no claim when a scientific exposition of principles is specially desired. So in descriptive and statistical works the terms and divisions adopted by positive financial legislation have to be followed, subject to whatever qualifications scientific arrangement may necessitate. In an investigation of general finance, the grouping of topics ought to be based on the underlying economic and social conditions, and aim at bringing out their relations as clearly as possible.[1] Besides, different arrangements naturally tend to place different parts of the subject in prominence, and thus study of a new, even if on the whole inferior, system of grouping will suggest novel points of view to the inquirer.

§ 4. We have already suggested in the preceding criticisms the arrangement that appears to be most suitable. It has now to be more fully stated. The widest division of public revenue is into (1) that obtained by the State in its various functions as a great corporation or 'juristic person,' operating under the ordinary conditions that govern individuals or private companies, and (2) that taken from the revenues of the society by the power of the sovereign. To the former class belong the rents received by the State as landlord, rent charges due to it, interest on capital lent by it, the earnings of its various employments, whether these

[1] Cp. Wagner, i. 474–5. For the *regalia*, cp. Sax: 'Die Regalien gehören der Wirthschaftsgeschichte und dem positiven öffentlichen Rechte an, die volkswirthschaftliche Theorie . . . hat mit ihnen nichts zu schaffen.'—*Staatswirthschaft*, 480.

cover the expenses of the particular function or not, and finally the accrual of property by escheat or absence of a visible owner. Under the second class have to be placed taxes, either general or special, and finally all extra returns obtained by state industrial agencies through the privileges granted to them. This course seems best calculated to satisfy the conditions of scientific accuracy and practical convenience. It places together distinct and well-defined parts of public revenue, and it separates the economic from the compulsory receipts of the State.

To test it in its relation to other divisions, we may consider the place it assigns to (1) the prerogative dues and (2) 'fees.' If these classes can be fittingly placed, then the arrangement may be said to be justified. A very slight examination shows that many, if not most, of the prerogatives or *regalia* are really special property-rights. Roscher has noticed that they originated in the mixture of landed property and sovereignty.[1] They are thus in their right place when classed along with other economic sources of revenue. In some instances, however, an element of monopoly created by law comes in, and where there is an additional receipt from this condition it is certainly a tax, and must find its place in the compulsory revenue of the State.

Fees admit of a somewhat similar analysis. Usually they are but a small return for the expenses of the state agency to which they are paid, and find a position among the private economic receipts as a deduction from the expenditure. It may even be best to subtract them from the expenses and charge the balance as net outlay, though in practice the wisdom of bringing all expenditure and receipts (not merely balances) into the budget is well established. In some cases it happens that fees just cover

[1] § 18. This confusion is characteristic of the feudal system. Cp. 'Among the many things which may be said about the system known to us as Feudalism, one of the least doubtful is that it mixed up or confounded property and sovereignty.' Maine, *Early Law and Custom*, p. 148.

all expenses, and then the public office or agency is a state industry that pays its way. Up to the point at which ordinary profit is obtained the same title is justified, but when (the institution being exclusively a public one) ordinary profit is exceeded, the monopoly possessed by the office is employed for taxation. It therefore follows—and this is perhaps the greatest difficulty that our classification raises—that one and the same public institution may occupy different positions in this respect at different places or times. The Post Office, for example, may be a purely public function involving expenditure, as the earliest government Posts probably did; it may in another country, or at a later time, just cover its expenses, or even pay fair interest on whatever capital it employs,—such has been at times the position of the United States Post; or, lastly, it may, as in England at present, give a large surplus to the general revenue, when its charges become a tax on communications, though, as we shall see, sometimes admitting of full justification.[1] In truth this apparent defect is a reason in favour of our grouping of the forms of revenue. Such institutions as the Post Office are in this respect different in different countries, but in all they are capable of presenting the three elements of expenditure, industrial revenue, and tax revenue. In treating of economic expenditure we have already noticed the first aspect;[2] in the present book we shall consider the second, reserving the last for its appropriate place.

Some classes of fees, *e.g.* law fees, are closely connected with the primary functions of the State. They then approach so nearly to taxation as to be best classed with it. There is an appearance of straining the conception of state industry by including them under that head. Here acquaintance with the historical development is of use in establishing that in their origin such fees were strictly payment for service done; and even when this element has

[1] See for further discussion of this point, Bk. ii. ch. 3, § 9 n.
[2] Bk. i. ch. 6, § 2.

been obscured by the increase of state power, it gives place to that of special as opposed to general advantage, a distinction on which so much of local taxation turns, and which can be applied to the class of fees under consideration.

§ 5. So much suffices at present with reference to the general classification of public revenues. We have now to arrange the subdivisions of the quasi-private income in their natural order. The great importance of this part of the receipts in less developed societies made it a subject of greater attention formerly than it is now, and led to those long lists of the heads of revenue above referred to. The modern student of finance gains little from these enumerations, made in all cases from the legal or administrative point of view, but he is impressed by the fact that such receipts are regarded as the 'ordinary' revenue of the State, taxation being merely an occasional resource. This idea survives in Blackstone's chapter on 'The King's Revenue,' where the tax revenue is regarded as 'extraordinary.' Even such recent writers as Mr. Dicey have to notice this division, and the fact that the change in circumstances has made the old terms seem incongruous.[1] A classification of the quasi-private funds of the State must, it would seem, have to follow the lines of the analysis of individual incomes made by economic science. One of the most valuable of Adam Smith's investigations was that presented in his chapter on 'the component parts of the price of commodities,' since it not only gave a starting point for all later analyses of cost of production, but it afforded in outline a scheme of economic distribution, and it is on it that the discussion of taxation in the *Wealth of Nations* is based. Its main point consists in showing that all incomes can be

[1] For the view of taxation as an occasional resource, Neumann, *Progressive Einkommensteuer*, 1, 2, and the references there given. Also Blackstone, Bk. i. ch. 8, and contrast Mr. Dicey's view. 'We may therefore, putting the hereditary revenue out of our minds, direct our whole attention to what is oddly enough called the extraordinary, but is in reality the ordinary or Parliamentary revenue of the nation.'—*Law of the Constitution* (1st ed.) 316

separated and referred to one or more of the three categories of rent—the return on natural agents; wages—the reward of labour; and profit—the gain on capital. The State's economic revenue must be capable of being put under the same heads, but the general doctrine, as it appears in the work of its originator,[1] requires two corrections before we can use it in this connexion; for first, the massing together of the interest on capital and the earnings made by its productive use is now perceived to be inaccurate. The function of the capitalist is distinct from that of the 'undertaker' or 'employer,' and is so distinguished in later economic works.[2] Another correction is needed for the present application. The category of 'wages' cannot enter into the public receipts; the State often pays, but never receives, a reward for labour. Any apparent exceptions really come under the head of 'undertaking' or 'management' of industry. We thus get three broad divisions of the public industrial revenues, viz. (1) the receipts of administrations, central or local, from rent of land or similar natural agents; (2)—and this is obviously a less important source—the gains of the State as capitalist or lender of funds; and (3) the returns to the industrial activities of the public power. Such a grouping would appear to be clear and logical, but it needs some further modification to bring it more into accordance with the realities of actual finance. Instead of confining our attention to the State as a landlord in receipt of rent, we shall find it more convenient to consider all its dealings with its agricultural property, whether retained in its own hands or let out to tenants. In like manner the treatment of mines may most suitably be placed along with the State's action as employer or undertaker of industrial operations. Two additional topics will also have to be brought into the list.

[1] Though the root-idea of the analysis can be traced back to the Physiocrats, yet Adam Smith originated its form and applications.

[2] The text-books of General Walker, Dr. Sidgwick, and Prof. Marshall are instances. The separation between capitalist and entrepreneur is made both by J. B. Say and Rau.

The many and various fees and dues may be combined with the rent-charges and other settled sums payable to the State, and also with the interest on loans made by state authorities, the whole class being connected by the common idea of fixed payment, that is for the most part capable of capitalisation. And finally, to the revenue-yielding industrial domain we ought to add those forms of state property that either give no direct returns or whose expenses exceed any receipts that they may bring in.

In short, to sum up, our discussion of the public economic revenue may, partly on grounds of logical arrangement partly for practical convenience, deal with (1) returns from land, including forests, (2) industrial revenue, (3) payments which either represent, or can be converted into, a capital charge, with much administrative revenue, and (4) those forms of property that yield not revenue, but utility in a less distinctly measurable form.

NOTE

Since the publication of the first edition of this book, the question of classification has been discussed by Professor Seligman in a special article,[1] in which vigorous criticism of the views of preceding writers is accompanied by the exposition of a new mode of grouping, believed to be more in accordance with logical requirements. As the acceptance of this system would necessitate extensive changes in the arrangement adopted in the text, it seems right to state briefly the reasons for retaining our former classification.

The general advantages that result from a good method of grouping public revenues are admirably stated by Professor Seligman, whose opening pages may be referred to as supporting what has been said above on that subject.[2] A single point of difference should, however, be noticed. We have sought all through to insist on the essentially relative character of classification. No system is in itself absolutely good or bad; each must be judged by its fitness for the purpose for which it is employed. And further, a system will hardly combine all possible advantages with no disadvantages. Any arrangement will probably have something to recommend it, and will bring out features that would remain unnoticed in a different system. On the other hand

[1] 'The Classification of Public Revenues,' *Quarterly Journal of Economics*, April 1893, vii. 286–321, now forming ch. 9 in his *Essays in Taxation*, to which work the references are made.

[2] Cp. Seligman, *Essays*, 265–6, with Book ii. ch. 1, § 3 *supra*.

Professor Seligman appears at times to maintain that there is one, and but one, perfectly logical arrangement, compared with which all others must be regarded as altogether erroneous. It is true he admits that historical circumstances may alter the mode of classifying, but for modern times no such allowance is to be made, and the least departure from the one 'correct' classification becomes deserving of censure. This view is, however, far too narrow. As Jevons points out,[1] the distinction between 'natural' and 'artificial' systems of classification is really one of degree. When we are dealing with the classification of organic species, there is the guiding principle of arrangement according to descent,[2] which makes the genealogical grouping the scientific one. But in such subjects as grammar, jurisprudence, legislation, and finance, this element is a subordinate one, and we have to take into account the convenience of a classification in considering the advisability of its adoption.[3] Such is the procedure recommended alike by logic and the practice of the best investigators in those branches of knowledge. Applying this test to the particular matter in hand, we cannot avoid coming to the conclusion that the arrangement in the text, if less elaborate and less complicated than Professor Seligman's, is at least as well suited to exhibit in their order the chief features of interest in the financial system. The briefest inspection of the receipts obtained by public authorities suffices to establish the existence of (1) economic revenue and (2) taxes as the two great forms of income. These are broadly contrasted, and must form the basis of any division: it is to their discussion that by much the largest part of any work on the subject must be devoted, and it is by the way in which he handles them that a writer will be judged. Now is there any other form of revenue that can fitly be regarded as 'co-ordinate' with these great categories? To this question Professor Seligman replies in the affirmative, while the answer we have already given is in the negative. To justify our position, let us briefly consider the three classes of receipts which are put forward as entitled to so prominent a situation. These may be briefly described as consisting of 'fines,' 'fees,' and 'special assessments.'[4]

'Fines and penalties,' we read, 'form by themselves a class of compulsory revenues, levied according to definite but non-fiscal principles. It is obviously wrong to class them with fees as do some writers, or to ignore them entirely as do others.'[5] It is, of course, true that fines are a part of state receipts which should not be 'ignored,' but it is equally true that they cannot be regarded as co-ordinate with taxes or economic revenue. Their yield is trivial,

---

[1] *Principles of Science*, 679–80. [2] Darwin, *Origin of Species*, ch. 14.

[3] Professor Plehn has distorted this statement into the assertion that 'Professor Bastable claims that the sole consideration in the choice of a classification in such subjects as "grammar, jurisprudence, legislation, and finance" is convenience for the immediate purpose in hand.' *Political Science Quarterly*, xii. 84. Contrast with this *supra* Book ii. ch 1, § 3. 'The merits of any particular classification depend partly on the end in view.'

[4] Professor Seligman's tabular arrangement, *Essays*, 302, would seem to give 'fines and penalties' even a higher rank. They result from the 'penal power,' and are opposed to special assessments, fees, and taxes, which are due to exercise of the taxing power; but this is comparatively unimportant.

[5] *Essays*, 268.

and their relation to the financial organisation of the State is remote. To give a separate book of a treatise on finance to fines and penalties would, to adopt Austin's phrase, 'somewhat smack of the ridiculous.'[1] The slightest and most cursory mention is the one best suited to give the reader a proper feeling of their financial insignificance.

With respect to 'fees' the case is different. A plausible argument may be framed in support of an arrangement that puts them in a prominent place, but, on the whole, the objections to this procedure appear to outweigh its advantages. An abstract distinction between 'fees' and 'taxes' may easily be made, but cannot be applied with satisfactory results in practice. Nor will it be easy to secure agreement as to the true boundary line. Professor Seligman himself disagrees with nearly all his predecessors, and confines the fee revenue to that derived from monopolised enterprises. Even then, if profit is obtained, the charge becomes a tax. Thus it would seem that, to take a concrete case, the British letter-post charge is a 'tax,' payments for telegrams are 'fees,' while the parcel-post service, not being a monopoly, charges a 'price.' Put in a general way, the distinction seems acute, and to some minds satisfactory, but what is to be said as to its practical convenience? Must the Post Office revenue be broken up into these several parts and its *disjecta membra* scattered over several distinct books? Such a course would, we believe, be altogether out of place in an orderly and systematic exposition of financial principles and facts. The different position of similar institutions in different countries further increases the difficulty. Are Prussian railway fares to be treated under 'taxation,' while Australasian ones are discussed when dealing with 'fees'?

But a more serious difficulty remains. Perhaps the commonest use of 'fee' in this sense in the English language is its employment to describe the charges made for various official acts. We speak of 'court fees' or 'registration fees' far more readily than of 'postal fees.' In those cases, however, the idea of equivalent service is not very prominent.[2] A certificate of birth or the issue of a writ involves some payment, but in each case there is really a small contribution towards the expense of a public department, not a charge based on 'the special benefit accruing to the individual.'[3] In fact, this kind of fee is essentially 'incidental revenue,'[4] and it is noteworthy that the earliest

---

[1] *Jurisprudence*, i. 237.

[2] Professor Plehn tries to meet this objection by referring to the change of meaning in the terms 'value, rent, wages' made by economists. But his own explanation shows that there is no real parallelism in the two cases. 'A word adopted from daily life by science must,' he says, 'be deprived of some of its "extension" for the purpose of giving it a perfectly clear "intension,"' *Political Science Quarterly*, xii. 85. The term fee has not been treated in this way. Its 'extension' has been enormously increased, and, as a necessary consequence, its 'intension' has been reduced, and, judging from the somewhat dreary disputes on the matter, has lost, not gained, in clearness. It may be remarked that if '*Gebuhr*' is to be translated into English, 'due' is the least inappropriate equivalent.

[3] *Essays*, 275.

[4] Cp. *infra*, Bk. ii. ch. 4, § 10.

systematic writers took exactly this view. Professor Seligman will not allow that Rau was the originator of the separation of fees, and refers to Justi as having perceived their existence. Both Justi and his contemporary Sonnenfels do, indeed, speak of 'casual revenue' (*Zufällige Einkünfte*), and this is precisely what fees are. They come in, if not as a windfall, at least as a by-product, a characteristic which prevents their being entitled to be classed as co-ordinate with taxes. The transference of one large portion of the matter, sometimes placed under the head of fees, to that of economic revenue, and of another less extensive portion to the category of taxation, leaving the miscellaneous residue to come in as an appendix to the treatment of the former, commends itself as a logical and convenient distribution of material.

The third distinct category is of greater interest. Special assessments may be fairly described as an American creation,[1] and it was therefore fitting that American writers should introduce them to the scientific students of finance. This pleasing duty has been ably performed by Professor Seligman and his pupil Mr. Rosewater,[2] and the European writer will henceforth be compelled to enlarge his descriptive material in order to include this new phenomenon. It is not quite so certain, however, that he 'will have to revise his classification.'[3] That will depend on the view he takes of the character and working of these charges. One of the first features of the special assessment that attracts notice is its strictly local application. It is a product of a particular form of local finance, and has apparently little or no place in general receipts. Following out the clue thus supplied, we discover that the special assessment is a mode of distributing burden according to advantage received, and has thus one point of resemblance to the special improvement rates that British local bodies frequently levy on limited areas receiving advantage from work done. The doctrine that 'special assessments must always be proportional to benefits'[4] is merely an example of those legal fictions so dear to the minds of American judges and lawyers, since 'acreage, frontage, value, superficial area,' may any of them be taken as the measure of presumptive benefit (a benefit which, it should be added, may never be realised),[5] and therefore the limitation of proportionality is effectually evaded. In any case there is no necessity for proportional charge. A sovereign legislature might levy assessments at a heavier percentage on those who held larger masses of property, or, in other words, it might permit the smaller owners to retain a greater part of the benefit or 'betterment' that the improvement had produced.[6]

---

[1] The few European instances are not prominent enough to attract attention.

[2] See the excellent study entitled *Special Assessments*, by the latter.

[3] This is Professor Seligman's expressed belief. *Essays*, 292.

[4] Seligman, *Essays*, 286.

[5] See on this point the following American cases: Matter of Church, 92 N.Y. 6; Allen *v.* Drew, 44 Vt. 174; N. Indian Railway Co. *v.* Conelly, 10 Ohio, 159.

[6] It is also possible, and actually happens, that taxation is by constitutional provisions confined to proportional charges.

Thus it seems that the line of demarcation between special assessments and taxes is by no means so sharp as Professor Seligman supposes. The real characteristic of the former is their imposition as a single charge on property instead of being a recurring charge on income.[1] They belong, in mercantile language, to the 'capital,' not to the 'profit and loss' account. But in this respect they are paralleled by taxes levied for a single great occasion, *e.g.* a war or the discharge of debt.[2] In estimating the financial position, it is important to keep both 'capital' and 'revenue' accounts in view; this, however, need not hinder us from regarding a capital payment as a tax levied *uno ictu*, instead of by recurring charges. When local bodies have recourse to this method, the circumstance deserves to be noted, but does not call for any revolutionary change in arrangement.[3]

Prof. Plehn, in an article entitled 'Classification in Public Finance,'[4] has sought to support Prof. Seligman's arrangement, and has criticised the views expressed in this note. He has, however, failed to understand them, and has been led into several misrepresentations, some of which have been already pointed out. Thus he seems unable to grasp the idea that the principle of classification is relative to the matter in hand; that an arrangement suitable for one purpose may be unsuitable for another. But this is a commonplace with logicians; it is familiar by practice to students of natural science, and should be equally so to investigators of social life.[5] 'It is unscientific,' says Prof. Plehn, 'in the study of legal institutions or economic life to confuse the old and new, or to classify in such a way as to hide the connecting links between them.'[6] No doubt 'confusion' is always unscientific, but combination of similar phenomena, though of widely different origin, is not. To take examples: the *emphyteusis* of Roman Law may be placed along with Irish judicial tenancies, and the English income tax with other charges on revenue, without reference to the wide differences in origin. In fact, one of the most instructive lessons in social inquiry is derived from the adaptation of diverse institutions and rules to accomplish similar ends.

Equally incorrect is Prof. Plehn's assertion that 'Prof. Bastable . . . denies . . . that there is any necessity for distinguishing between fees and taxes.' It is hard to understand how any one who had read the sections on 'Administrative Revenue'[7] could have committed himself to so misleading a statement. It is hardly necessary to state once more that there is no denial of the existence of so-called 'fees.' What has been urged is (1) that 'fees' are

---

[1] 'Special assessments are paid once and for all.'—Seligman, *Essays*, 289. Cp. Rosewater, *Special Assessments*, 129.

[2] Ricardo's plan for paying off the National Debt may be given as an instance. See his *Works*, 545–6; and cp. Cannan, 'Ricardo in Parliament,' *Economic Journal*, iv. 421–3.

[3] On this point Prof. Plehn is a supporter of the view taken above, though he regards it as partly based on an entire misconception

[4] *Pol. Science Quarterly*, xii. 82–92.

[5] In addition to the references given above, see Mr. Montague's article in the *Dict. of Pol. Economy*, i. 303.

[6] *Pol. Science Quarterly*, 84.

[7] See Bk. ii. ch. 4, §§ 7–10.

not a class *co-ordinate* with 'economic revenue' and 'taxes.' (2) That some fees are really 'industrial,' that others are 'special taxes,' while the balance may best be described as 'miscellaneous receipts.' (3) That the heterogeneous character of 'fees' is proved by the divergence of opinion respecting their character and boundaries. The practical outcome of these views is the treatment of a large section of fees as a kind of appendage to economic receipts, and this course is supported by Prof. Plehn's 'practice,'[1] which in this, as in many other cases, is better than his 'theory.'

[1] Plehn, pt. ii. ch. 11.

CHAPTER II

THE STATE DOMAIN. LANDS AND FORESTS

§ 1. THE oldest form of public property undoubtedly consists of the territory on which the society is situated. There is a great body of evidence to show that communal holding of land is far more persistent and enduring than other kinds of common enjoyment. The witness of history is moreover supported by all the probabilities of the case. Until agriculture has extended and improved with the growth of population, a large part of the tribal land must lie waste or be only used for pasture. It remains under the control of the community or, at a later time, of the chief. Public land is increased by the action of war; the land of the vanquished becomes the property of the conquerors and goes to swell their public domain. But a counter-process is found steadily operating in the allotment to individuals of parts of the domain. The Roman *ager publicus* dwindled in extent under this influence, and the territory of the Provinces—in technical law the property of the Commonwealth[1]—was 'possessed' by individuals with the substantial rights of ownership. A public domain was notwithstanding retained, and some of the local revenue was derived from the letting of land, though it was largely supplemented by other sources. The earlier Middle Ages regarded the royal domain as the basis of public income.

[1] Cp. the statement '*Provincialia prædia usucapionem non recipiunt.*' Caius, *Institutes*, ii 46.

The feudal King was the greatest landholder, and was expected to discharge the necessary public duties by aid of the revenue that he obtained from that source. The same opposing forces that were operative in earlier times continued to affect the royal lands. They were reduced by lavish grants to royal favourites, and increased by resumptions and forfeitures. The position of the domain depended very much on the strength or weakness of the individual monarch, improving in extent during vigorous reigns and shrinking considerably in feeble ones.

The later history of the domain varied in detail in each European country, but one very general result is found in the transformation of what had been the King's estate into public property. In the few cases where royal or princely estates have remained in the possession of the reigning family, they are nevertheless, in substance, public, inasmuch as they supply the ruler's official income, and by rewarding his services relieve the treasury from an equivalent charge.[1]

§ 2. The disintegrating forces that tended to break up the great state domains, as well as the other parts of mediæval finance, did not everywhere act with the same intensity. Owing to peculiarities of situation, and in some degree to differences of policy, the proportion of state domain is at present hardly the same in any two countries. England is remarkable for the almost complete alienation of its Crown lands, the revenue derived from that source being one of the most insignificant in the budget of receipts.[2] 'It was in the fifteenth century that,' according to Thorold

[1] The distinction between the property of the ruler as a private person and that which accompanies his office is now of little interest. It was emphasised in the Roman Empire—*res privatæ* opposed to *res fiscales*—(Humbert, i. 187 sq.), and was of much importance in Germany in the case of mediatised princes, who naturally tried to stretch the private element as far as possible. In practice the same end is reached by different means in modern States, as in the cases of Baden and Würtemberg, noted by Roscher, § 9.

[2] The net receipts in the year 1900–1 were £500,000, or less than one-half per cent. of the total receipts. The revenues of the duchies of Lancaster and Cornwall should in strictness be added with a corresponding item of expenditure for the sovereign's support. Bk. i. ch. 6, § 5.

Rogers, 'the great impoverishment of the Crown estate began,' and though increased by the dissolution of the monasteries by Henry VIII, it was again reduced by his successors until it reached its present position at the commencement of the eighteenth century.[1] In France also a series of losses has reduced the public lands held by the central government to a very small amount, with the exception of forests, of which it possesses 1,070,477 hectares (about 2,650,000 acres). There is, however, a remarkable difference as compared with England in the large quantity of land held by the *Communes* or local units. These bodies in 1877 had 2,058,707 hectares (or, in round numbers, 5,000,000 acres) of forests and 2,258,310 hectares (or 5,600,000 acres) of other land, most of it being of very poor quality. The productiveness, however, as distinguished from the extent of this property, is not considerable; in 1877 the receipt from communal property, including other items than land, was only 51,702,694 francs, or little over £2,000,000, showing less than £40,000 increase since 1862. These figures need some further correction, since a large amount of communal land has been sold, and in some cases timber has been freely cut down. Thus in 1877 over 24½ million francs were obtained from those extraordinary resources that had for the earlier year 1862 yielded over 34 million francs. It accordingly appears that a sum of about £3,000,000 was the contribution from immovable property for 1877 towards a total communal expenditure of about £27,000,000.[2] It is plain that neither England nor France can hope for much financial advantage from public lands either general or local. The policy, or at all events the desire, of alienation has been too strong, as the speedy disposal of the confiscated estates of the clergy and the emigrant *noblesse* shows in regard to France.[3] Nor

[1] *Economic Interpretation of History*, 417 sq.

[2] Say, *Dictionnaire des Finances*, s. v. 'Budget Communal.'

[3] The most careful estimates place the amount of immovables disposed of during the revolutionary period at £220,000,000, *i.e.* £120,000,000 for Church and Crown lands, £100,000,000 for those of the *émigrés*. Stourm, ii. 461.

are the cases of Italy and Spain substantially different. The heavy expenditure that the accomplishment of Italian unity necessitated was partly met by sale of the state lands, and at a later time by confiscation and sale of the possessions of the ecclesiastical bodies so numerous in that country. By 1886 over £33,000,000 had been realised through those sales, and by far the greater part of the lands had been disposed of.

The countries of Eastern Europe are differently situated. Germany, Austria, and Russia all possess large public estates—a circumstance that may be fully explained by the later growth of constitutional government in the former, and its absence as yet in the last-named. A State that cannot rely on taxation as a resource at need must provide other financial support, and taxation is productive only on the condition of general willingness to contribute. States, therefore, in which royal power has not been completely displaced by popular government will probably retain a larger amount of public land. The position of Prussia illustrates this proposition. The budget estimate for 1902–3 gives a gross receipt of 106,854,000 marks, and after allowing for the working expenses of over 46,653,0000 marks, there is a net revenue of about 60,000,000 marks, or £3,000,000. The Bavarian domains are, in proportion, larger and more valuable than those of Prussia. The biennial budget estimated the yield for each of the years 1898 and 1899 at 38,800,000 marks. Würtemberg, Baden, and Saxony also have large domains, chiefly forests.

Austria and Hungary have each state lands and forests, the estimated revenue in the former country from that source being over 5,000,000 florins, and in the latter 2,500,000 florins.[1] Russia is a more remarkable case: it illustrates the statement that the less the development of the society the greater is the proportion of public land. At the time of the great reform usually known as the emancipation of

[1] The estimate for the Austrian domains and forests for 1891 was less than 500,000 florins (net revenue).

the serfs an amount, estimated at from two-fifths to one-half of the land of Russia, was held by the State. About eighty years earlier 10,500,000 serfs were found on the state lands, and in 1861 this number had increased to 23,000,000. The measures of emancipation—so far as the state domain was concerned—consisted in a readjustment of the dues that were payable, which henceforth, in many cases, assumed the form of taxation, either imperial or local Economic inquiries are said to show that rent has been evolved from taxation, but it is equally true that in many cases taxation has passed into rent, or rent-charge. In some parts of Russia the state charges on the former imperial serfs are higher than an economic rent, in others they are lower, and in the latter case they may be looked on either as a reserved property or as a land tax. It appears in this way that the income of the State as land-owner may approach very closely to the tax revenue that is imposed on land, and that the line of separation can only be fixed with reference to all the circumstances of each particular case. In addition to this wider form of state domain, the Russian government received, in the year 1900, over 76,500,000 roubles from lands and forests, though the expenditure on the same objects (40,600,000 roubles) has to be deducted to arrive at the net gain.[1]

The Indian land tenures present the same features even more forcibly. Under all the varying forms of assessment the principle that the State is ultimate owner has not been, in practice, completely lost sight of, except in the settlement of Bengal. Nothing appears more equitable than that this head proprietor should receive a share of the increasing value of the soil. On the other hand, the machinery of assessment and collection is compulsory; it is nearer akin to the process of the tax-collector than of the land-lord, and the difficulty recurs of saying whether the receipts are taxes or rent. The best solution of this question is arrived at when we see that in strictness they belong to

[1] For the position of the state serfs, see Wallace, *Russia*, 105, 473, 553.

neither class.[1] They differ most markedly from the rent, either customary or competitive, of a modern landowner, and more nearly resemble the dues of the feudal lord. They are just as distinct from the ordinary tax, and are not governed by the canons to which it ought to conform ; at the utmost they might be assimilated with the taxes on special advantages or monopolies, of which class the possession of land is one example. Where the state dues are frequently revised in accordance with the movement of land values the approximation to rent is very close ; where they are changed in order to suit the needs of the State, they are practically taxation ;[2] but where, as is most common, they are fixed for long periods, or in perpetuity, they are really charges that may be capitalised at the market rate of interest. The Indian Land Tax, with its great net return of nearly £20,000,000, has, at different times and in different provinces, shown each of the three features, but on the whole the rent-charge element has preponderated over the others. The lengthening of the period of settlement, and the disposition to keep the assessment under the value, have both tended to this end.

§ 3. European colonies, and more particularly the English settlements in North America and Australasia, contrast remarkably with the preceding cases. The most prominent economic features in a new country are abundance of land with scarcity both of labour and capital ; land is consequently the cheapest of commodities, so much so, that it is freely offered in full ownership as an inducement to fresh settlers. The progress of cultivation soon changes this state of things. The more fertile land is taken up, and

[1] 'It is also fruitless to discuss exactly what the Oriental institution of a Land Revenue is, whether a "land tax," or rent, or what. . . . Practically the discussion is a profitless war of words, and we may be content to speak of the "Land Revenue" as a thing *per se*.' Baden Powell, *Land Revenue in British India*, 49.

[2] 'It seems to me that the distinction between a tax and a rent is merely a matter of amount ; and that if a land tax is so high as to absorb the rent it becomes in fact rent.' Campbell in *Cobden Club Essays* (1st series), 130–1. Cp. Marshall, *Principles* (3rd ed.), 727 n.

acquires value from the growth of population. At first sight it seems that the State might derive important resources from a reserved charge on its land, or, by adopting the simple expedient of leasing it out, instead of giving it away, would obtain a share of the increase in its value. The Wakefield system, though not designed for financial ends, sought to secure a higher capital return for land that was sold, at the same time applying the funds so derived for the promotion of immigration; in fact, increasing both colonial receipts and expenditure. The advantages of free access to land are, however, so great in a new country, the effect on economic development of a speedy growth of population is so considerable and so easily perceived, that no effectual method of limiting the occupation of the soil in full ownership has been continued. The United States, the various English colonies, and the South American republics have all found that nothing is such a stimulus to immigration as full liberty of acquiring vacant land. For this reason the revenues of those States from land are, comparatively speaking, small, and for obtaining the necessary funds recourse must be had to other forms, principally indirect taxation. As examples it appears that in 1889 the United States obtained over £1,600,000 by the sale of public lands, but against this the expenses on the same account have to be set off, and the result seems to be that on the whole there is a loss on the state lands: they really are an item of expenditure, not of receipts.[1] For the financial year 1892–3 the Canadian land receipts were a little over £65,000, though it is hoped that in future years the return will be greater. In the same year the Australasian colonies received £4,150,000.[2] Thus

[1] 'Except for the period 1830 to 1840 the lands have been a drain upon our finances. At the end of the financial year 1882–3 the government was out of pocket . . . . in the sum of more than $126,000,000.' Hart, *Essays on American Government*, 241.

[2] The precise figures are—

United States land sales, 1888–9	$8,038,651·79
Canada land revenue, 1891–2	$365,117
Australasian colonies, 1891–2	£4,149,896

neither in new nor in old countries are state lands one of the main supports of the financial system. It requires an extraordinary combination of circumstances, as in the case of India, to create an exception to this general rule.

§ 4. The apparent advantages of a large state revenue from land and the peculiar nature of the income received from the use of superior natural agents have suggested the advisability of dispossessing all private owners and reverting to the primitive system of public ownership. Whether levied under the name of rent or of the single tax, this plan of imposition involves the confiscation of all existing rights in land. Its bearings, when regarded as a form of taxation, belong to the theory of that part of our subject, but we may at present notice it in so far as it advocates an extension of state property. And here there is an evident distinction to be made. In one form of the proposal, existing owners are to be compensated, when it simply amounts to an extension of the state domains by purchase. In the other and more drastic form no compensation is to be allowed. Owners of land, no matter how acquired, are to be compelled to surrender their incomes from this source to the State. It is not necessary to characterise the morality of this scheme, but its financial attractiveness, at first sight great, is much diminished on closer examination. The disturbance of economic relations and the general feeling of insecurity that the adoption of such a measure would produce, even on the assumption that it could be carried into effect without a revolution, would go far to reduce the productiveness of land to the

The proportion of land revenue to the total receipts in each of the last-mentioned colonies was as follows :—

Western Australia	14·46 per cent.
New South Wales	21·08 ,, ,,
Queensland	19·56 ,, ,,
South Australia	9·14 ,, ,,
Tasmania	8·08 ,, ,,
New Zealand	7·97 ,, ,,
Victoria...	6·72 ,, ,,
Average	13·82 ,, ,,

State, and to lower the incomes of other classes of the society in whose interest the measure is advocated. In another way, too, the gain would be reduced. The large amount of general and local taxation at present raised from land, as also the necessary expenditure for keeping it in proper condition, must be deducted before the net advantage to the Exchequer can be known. Besides, all the difficulties attendant on state management of land would exist in at least equal strength if it were acquired without paying its fair value.[1]

§ 5. From these far-reaching and unsafe theoretical plans we may now turn to the actual questions connected with the public ownership of land. They are divided into two groups, the first of which considers the advisability of the State retaining its domains, and the second, taking the retention as desirable, investigates the best methods of administration. As the former comprises the already noticed question of land nationalisation with full compensation, we shall find it convenient to commence with it.

At the opening of scientific economic inquiry the treatment of state lands was a subject for discussion. German writers, *e.g.* Justi, favoured their retention as being a better source of income than taxation, but the tendency of the new doctrines of the Physiocrats and Adam Smith was in the opposite direction. Taxation in the form of a direct charge on the net revenue of land was regarded by the former as the proper support of the State, and the latter has unequivocally pronounced in favour of the alienation of the public domain. 'The revenue which in any civilised monarchy the crown derives from the crown lands, though it appears to cost nothing to individuals, in reality costs more to the society than perhaps any other equal revenue which the Crown enjoys. It would in all cases be for the

[1] The idea of state ownership of land, based on an application of the economic theory of rent, first appeared in James Mill's *Elements*. He was probably led to it by his study of India. J. S. Mill, in the later years of his life, maintained a like opinion, which in later years has been urged with much enthusiasm by Henry George, and in Australia by Mr. Syme.

interest of the society to replace this revenue to the crown by some other equal revenue, and to divide the lands among the people, which could not well be done better perhaps than by exposing them to public sale.'[1]

The reasons given in favour of this policy are clear and simple. Firstly, the lands held by the State are managed so badly that the revenue of the society would be increased by their alienation, since the produce obtained from them would be larger. The price obtained by the government would go to discharge liabilities, and therefore the amount of receipts, if not larger, would certainly not be less; and finally, the improvement of the alienated lands, under the management of private individuals, would, by adding to the source from which taxes are drawn, make their yield greater. The case as so presented is a strong one, and, in the main, convincing. Nevertheless, the German writers on finance have regarded this view of Adam Smith's as one-sided and exaggerated. His condemnation of state property is, it is said, too absolute, and various arguments in favour of the retention of state domains have been put forward. Thus the advantage of such property as a security for public loans is suggested as a reason for its retention; also its use as supplying model estates on which improvements may be introduced as a means of instruction to agriculturists. The political gain to the Crown from possessing an independent source of income and the prospect of the value and return of land increasing through the progress of society, are given as further reasons in favour of retention. Most of these pleas are unfounded: if public lands are a security for loans, their sale would prevent the need of borrowing. The royal income is just as secure when settled on the civil list; no matter what be its form, a revolution will disturb it. The

[1] *Wealth of Nations*, 347. Cp. the opinion of Burke, 'A landed estate is certainly the very worst which the Crown can possess. All minute and dispersed possessions, . . . which require a continued personal attendance, are of a nature more proper for private management than public administration.' Speech on Economical Reform (1780), *Works*, ii. 79.

value of model estates is a distinct and separate question, and belongs rather to expenditure than to revenue, so that the only valid argument remaining is that derived from the growth of rent or unearned increment. The question, however, remains, whether this very growth is not in great measure due to the incentive that private ownership of land gives, and which is removed by state appropriation. Still it must be admitted that, more especially in the case of land suited by position for building sites, there is a decided advantage in reserving the constant increments of rent for public use ; and that any equitable mode of accomplishing this end would be deserving of approval. The retention of state or crown lands is of itself by no means sufficient for the purpose. Even in Germany or Russia the proportion of public land really at the full disposal of the State is only a fraction of the whole, and the part of it that is situated within urban districts is much smaller, so that it appears that under actual conditions the difficult question of unearned increment in connexion with ground rents must be solved, if solved at all, by special taxation. The contention of Adam Smith therefore holds good, that in general, from a purely financial point of view, the sale of lands in order to clear off debt or meet extraordinary expenditure is expedient. Underlying the discussion in the *Wealth of Nations* there are, it should be noticed, some assumed conditions that did really correspond to the facts in Adam Smith's time. These are (1) the existence of debt on the part of the State. While it is financially wise to dispose of property yielding small returns in order to discharge obligations paying a high rate of interest, it is not equally clear that alienation of property to meet current expenditure is justifiable. Expenditure of the normal kind should be met by equally normal receipts, and the sale of land is not of this nature.[1] Unfortunately, the case of com-

[1] The Australasian colonies, incorrectly as it seems, have placed sales of land among current receipts ; a partial exception is found in Victoria, where a small sum is carried to the Railway Construction Account, *Victorian Year-Book* (1887–8), i. 140.

plete freedom from debt is rather conceivable than actually existent, as every country has public debts to a larger amount than the sale of its domains would meet. (2) The expediency of selling the state domain also depends on the available market. In most European States in the eighteenth century there was no difficulty in finding an open market for the amount of land held by the sovereigns. But under other circumstances it would be hopeless to expect that large masses of land could be sold at their proper value, owing to want of capital and enterprise on the part of individuals. Such is plainly the position of India in those cases where the land tax is really a rent.[1] In addition to the political and social evils there would almost certainly be a financial loss from forced sales. The same statement would hold good for all new countries where the sale of land depends on the demand of fresh settlers, and where the amount disposable in any one year is limited.

The evident conclusion seems to be that the function of the State as owner of agricultural land is sure to decline in importance with the advance of society. The proportion that the quasi-private income of the State bears to tax revenue becomes smaller in the course of time ; and as the industrial domain has in certain directions a tendency to expand, the falling off in the yield from rent must be very decided. Though this will be the probable final result, it is also true that for a long period the management of state lands will be of practical interest in some countries, and will always remain as a problem of financial science. If the State, through its central or local organs, is the owner of landed property, it is desirable that property so held should be wisely managed.

§ 6. The methods of administering state lands may be reduced to the same classes as those existing in the case of a large private owner. As in the latter instance the estate may be worked by the proprietor or let out to tenants, so

[1] The sale of fee-simple estates to European settlers is emphatically one of those exceptions that prove the rule.

may public property be either directly under state administration or be leased to private individuals. The former system is probably the earliest. The capitulary of Charlemagne, entitled *de villis*, contains a set of regulations for the management of his manors, and in Germany several parallels are to be found,[1] but the same influences that caused land-owners to abandon farming by bailiffs affected the royal estates. A direct financial gain was procured by letting the land to tenants. To work effectively a large area of land requires a good deal of capital applied with intelligence, under diligent supervision. All these conditions were wanting in public or royal management, and therefore the economic advantages of the tenancy system were too great to be disregarded. The method of direct state administration as a financial policy has no supporters.[2]

The dealings of the State with agricultural tenants ought, it is plain, to be modelled on the system of a prudent landlord. There is no possible reason why the treatment of state domains should differ from that applied by private owners to the management of their properties. In two respects, indeed, the nature of the public power has peculiarities that affect its dealings with land. It is of longer duration than the individual owner, and it has necessarily to act through agents. A result of the former is the possibility of longer agreements and a more continuous policy in the system adopted: the latter makes the use of definite rules desirable, in order to prevent corrupt action on the part of officials. Even as regards these special features there is not much difference between state properties and those of the largest class of English owners where the method of estate management is handed on unchanged for generations, and most of the administrative work has to be done by paid representatives.[3]

[1] Roscher, § 11. [2] Not even Wagner, cp. i. 540–1.

[3] An 'interesting description of estate management is given in Escott's *England*, ch. 3. The following passage bears out the view in the text: 'The

The earliest agricultural tenants are probably to be found in the serfs who cultivated the soil and paid rents in labour, or produce, or both. The advance in personal liberty freed these cultivators from many of the more degrading incidents of their tenure, and by degrees they became established as free tenants paying money rents. In another way a class of larger tenants was created. Officials in charge of land were bound to account for a certain return, the surplus, if any, going to them; and this function of collecting dues, with the obligation of giving a fixed quota to the sovereign, became in many cases tenancy passing later on into ownership.

The application of what are called 'commercial principles' to the letting of land is of comparatively recent introduction, but it is only at this stage that the idea of conscious choice between different systems, hitherto followed through the blind influence of custom, comes prominently forward. Three forms of tenure are possible, viz. (1) tenancy from year to year, or in popular language 'at will,' (2) leases for years, and (3) heritable, extending to perpetual, leases. The first form has been almost universally condemned, though under the fair and impartial guidance of a public department it would be free from some of its most objectionable aspects. The undue increase of rent and the discouragement to improvements characteristic of the tenure would neither of them be likely to happen under state management. Leases for years are, however, free from even the chance of such evils, and it is perhaps wise to adopt this system, as otherwise the example of the public estates might be put forward to justify the conduct of private owners in adhering to yearly tenancies. The

Crown and the Ecclesiastical Commissioners are at the present moment the most extensive land proprietors in England, having the management of properties with a rental of upwards of £400,000, situated in all parts of the United Kingdom. These are administered upon practically the same principles which obtain in the cases of the large landed nobility,' 37. See also the evidence given to the Royal Commission on 'Agricultural Depression,' i. 1–19, 115–121.

exact number of years to be given in the state leases can hardly be decided on general principles. The term should be long enough to give full room for the application of the tenant's industry and capital, while in the interest of the public it should not exceed the time during which a large increase in the natural value of the land takes place Provided that full allowance is made for the tenant's improvements, thirty years seems a fair period, and sufficient to eliminate the effects of casual disturbances.

Older than leases for years is the system of hereditary lease (*Erbpacht*) that has from early times been connected with public property. The *emphyteusis*—the form that it takes in Roman Law—was originally developed on the estates of municipalities, and in the Middle Ages ecclesiastical bodies were foremost in granting similar tenures.[1] The advantages to a corporation of obtaining a settled rent without the trouble of supervision and calls for expenditure are greater than in the case of a single owner who hopes to gain extra rent by his attention and outlay, and, when combined with fines for change of possession, the revenue obtained is generally satisfactory. Nevertheless the hereditary lease is in reality a step towards alienation. The tenant holding by this tenure is part owner, and in course of time tends to take the position of full owner subject to a rent charge;[2] more especially is this true when the fines, as usually happens, are redeemed by a fixed payment. The head landlord,—*i. e.*, with regard to public lands the State—is substantially a creditor entitled to certain remedies if his obligation is not paid. What seems the most prudent policy, alike on financial and social grounds, with respect to state management of property, is to follow the system adopted by the best individual landowners, and the forms between which choice will generally

[1] For the origin of the *Emphyteusis*, see Gaius, *Institutes*, iii. 145; cp. the *Aforamento* in Portugal described by Laveleye, *Cobden Club Essays* (1st series), 241.

[2] Thus the *Emphyteuta* had for his remedy the *utilis actio in rem* closely analogous to the *Vindicatio* or owner's remedy.

lie are the lease for a sufficient term of years and the hereditary lease; the former is financially the wiser, but special circumstances may make the *emphyteusis*—to use the old title—more convenient, in which latter case the land revenue is practically converted into a fixed charge. Leases for lives are open to the objection that they are uncertain; but by judicious regulations as to renewals, much of the evil of insecurity can be avoided.

The modes of letting vacant farms, the duty of supplying buildings and permanent improvements, and the form in which rent is to be received, have all been carefully discussed in the older financial treatises. Most of these questions belong to practical administration, and are, moreover, not of great interest in modern times. Certain plain rules, may, however, be stated. The claims of successors to the late tenant should not be overlooked; it is better for the tenure to be continued without break, and therefore the question of new letting ought rarely to occur. When it does, the best mode of disposal will depend on the circumstances of the particular district; with capitalist farmers letting to the highest bidder is admissible, and it excludes all chance of unfairness. But where, as notably was the case in Ireland, there is exaggerated competition for land, the amount of rent payable over a series of years by a solvent tenant should not be exceeded. In such cases a sale of the interest, subject to a fixed rent, seems the best course. The supply of suitable buildings and the institution of permanent improvements must, under a system of short leases, be carried out by the State, but the modern plan of advancing public funds for improvements could be easily applied, the interest on loans being added to the rent and paid at the same time. Hereditary leaseholds may be safely left to the tenant, as he gains all the benefit of improvements. The form of rent ought clearly to be, as far as possible, in money. Special conditions may make payment in kind more convenient, but this mode of receiving rent should be only temporary, and all reasonable

efforts be tried to introduce the more definite system of money payments. Even where for practical convenience the rent is a fixed part of the total produce, the actual payment had best be in money, the various articles being estimated at their money value.[1]

§ 7. We are now in a position to deal more fully with the expediency of extending the state lands. In their extremest form plans of this kind aim at the acquisition by purchase of all private landed property. More moderate proposals seek to increase these possessions in a smaller degree. Any plan of the kind, even when limited in the most careful manner, is open to overwhelming objections. It amounts to the creation of a new public department engaged in countless dealings with what is the most intricate and complicated form of property; arrangements as to valuation, the renewal of leases, allowances for improvements, abatements for unexpected losses, the maintenance and audit of innumerable accounts would all fall to the lot of the department. It would, on the supposition of purchase, have to pay interest on a large amount of debt. There would be little hope of a favourable financial result under such conditions. In short, we may say that if land-nationalisation without purchase is palpably unjust, land nationalisation with purchase is as evidently inexpedient. The same arguments apply to smaller acquisitions of land. They have little chance of being remunerative, while they so far contract the supply of a much desired commodity, and they necessitate a class of administrative duties of exceptional difficulty. If the alienation of state lands should only be carried out with due care and deliberation, the acquisition of new estates can only be justified on non-financial grounds. Practical politics clearly conform to this rule of prudence. State lands are often alienated

[1] The transition to money payments is a mark of advance. This took place in England in the 12th century. See the Dialogue of the Exchequer, Book i, in ch. 7, Stubbs, *Select Charters*, 193-4.

and seldom acquired, and in these latter cases there is generally some social or political reason as the actuating cause. We may look on the slow decline of the state domain as one of the permanent facts of financial development.

§ 8. So far we have confined our attention to the case of cultivated land—of 'farms' as Carey would say—where the ordinary economic motives operate with considerable force. The State, it would seem, had best avoid entangling its interests with the difficult questions of land tenure, and can hardly expect any financial advantage from retaining its ownership of land. It does not follow that with regard to other closely allied forms of extractive industry it may not be expedient to retain, or even extend, public ownership. The principal example is afforded by forests, and in their case the wisdom of alienation is far less clearly established. Individual self-interest is not in the same general agreement with public advantage as in the case of ordinary agriculture. The creation of a forest is a work of time and technical skill which can hardly bring in recompense to the originators, and existing forests are a ready resource for the embarrassed owner. Moreover, forestry is only applicable to large tracts of land, and is most profitably carried on where the soil is of little use for other purposes. The estate of the large owner is, as we saw, not very differently managed from the state domain, and therefore some of the usual arguments against public ownership lose their weight. There is, besides, the important effect of suitable plantation on climatic conditions, and in some countries the need of wood as the only available fuel. There is here a striking example of failure in that harmony of individual and general interest which was so enthusiastically set forth by Bastiat and became a 'watchword' of what was supposed to be 'Political Economy.' The case against not simply state ownership, but even direct state management is accordingly deprived of its foundation;

while the promotion of his own interest had best be left to the individual, the interest of the community cannot always be safely entrusted to his hands. The real questions at issue are to be decided by estimates as to (1) the influence of other than purely self-regarding motives on the proprietors, (2) the amount of general interest that is jeopardised by the possible action of individuals, and (3) the probability that public management will secure the desired results. In reference to the first, it has been universally remarked that large proprietors are in many cases willing to give up a portion of present wealth for the future advantage and beautifying of their estates, while peasant proprietors show no such disposition, but, on the contrary, seek immediate gain by the removal of valuable timber.[1] The inattention of the State to forests in England compared with Continental countries is partly explicable on this ground. English proprietors have done at their own cost what foreign countries have to secure at the public expense. Another reason is to be added. The supply of fuel in England is not dependent in the smallest degree on the cultivation of timber, and the recent developments of naval architecture have destroyed the importance of forests as a source of shipbuilding material, the object to which the Woods and Forests Department principally attended. Considerations of climate are besides of less weight in the case of islands subject to the equalising influence of the sea. We can thus easily understand the peculiar attitude of England and the reasons for the very different policy of the Indian Government, where the circumstances are in all essential points reversed. The chance of success in state administration of forests depends on the application of the best scientific and technical

[1] 'Presque partout le paysan n'aime pas la forêt, dans le Midi il n'aime pas l'arbre ; il n'a qu'une faible idée d'utilité indirecte des choses. Les grandes et les moyennes propriétés, les parcs, auxquels s'attaque la frivolité démocratique, rendent à ce point de vue de réels services à la communauté.'—Leroy-Beaulieu, *État Moderne*, 124. The cutting of trees by peasant purchasers in Ireland is a good illustration of this general tendency.

ability to the work, which can only be attained by effective organisation. Among examples we may mention the Indian Forests Department and the Prussian administration. The benefit of a sound method of dealing with this part of the public domain is not mainly financial, though good management may make it yield a surplus. But, as appeared in dealing with expenditure,[1] it is quite possible that the general revenue of the State may have to contribute for the maintenance of the requisite plantings, in which case the policy has to be judged as a matter of expenditure.

§ 9. The necessities of practice have led States to a recognition of the special advantages of directly controlling forests. In all nations they form the largest part of the public land; the figures for France have already been given, and the same general features mark the position in other countries. The broad result is that about one-third of the forests of Germany is held by the States; about one-sixth by communes and quasi-public bodies; very little over half remaining in private ownership. In Austria one-fourth belongs to public bodies, and in Norway one-eighth.

The excess of forests over other state land is easily explained when we call to mind that they are the last remnants of the old common property. To a primitive community land with timber is of little service. When, at a later time, wood rises in value the one aim is to clear the soil as speedily as possible, and land still under trees is waste. The fact that planting often succeeds best on poor soil tends to confine it to land of this kind, since more fertile land is turned to other and better uses. The recent movement towards reafforesting is for the same economic reason directed towards inferior land, and it is only by adopting this policy that new forests can be made even tolerably remunerative. There is almost a consensus of competent opinion in favour of state action for the pur-

[1] *Supra*, Bk. i. ch. 6, § 3.

pose of increasing the area under trees, and directly administering those areas by a skilled and well-organised staff.[1]

Most European countries have a considerable area of uncultivated land which would be particularly suitable for planting, and a well-considered system of purchase by the State, perhaps accompanied and facilitated by the sale of the other parts of public landed property, is likely to be advantageous. The financial results cannot be of much importance. Prudence and judgment may, however, save a good deal of unnecessary expenditure and combine the two ends of public economy—utility and saving of effort.

§ 10. The division of control over landed property between the central and local governments can hardly be arranged on general principles. Historical conditions and the special features of each case are the principal factors in the settlement. Management by a central department is open to the dangers of laxity in administration along with pedantry in the application of inflexible rules. Public estates so placed have all the defects attributed to the absentee proprietor. Local bodies have a different but not less serious drawback, viz., the danger of jobbery and intrigue in the administration of what ought to be applied to the best advantage of the community. This evil is of varying magnitude according to the size of the body. Among the larger German States, as, *e.g.*, Würtemberg or Baden, it disappears completely. In a small French or Swiss *Commune* it is at its maximum. The dealings with public or quasi-public property by small corporate bodies need to be carefully controlled and regulated, and this necessity has been recognised. Thus the French *Communes* are unable to sell or grant a lease of their lands for more than eighteen years without the sanction of the Préfet in the council of the Préfecture.[2] The property of British

[1] Leroy-Beaulieu, i. 46–66, 91–2; Wagner, i. 571 sq.; Roscher, §§ 16, 17.

[2] Say, *Dictionnaire des Finances*, *s. v.* 'Communes,' 1120; see also *s. v.* 'Alienation,' 117–8.

corporations has in former times suffered from the want of such control, as has also that of the Swiss communes. When local government is applied to a sufficiently large area, and public spirit is operative, landed property is generally better managed than it would be by a central department. The concessions to tenants are more liberal, but, except where the land is within an urban district, its sale is probably advisable if there is a local debt sufficient to absorb the purchase money: where this is not so, there is the danger of the price, which is really capital, being treated as current revenue. The retention of building sites by corporations is, where practicable, the happiest solution of the vexed problem of taxation of ground rents, and their alienation should not, unless in the exceptional cases of extraordinary pressure or special encouragement to small proprietors, be sanctioned.

The above considerations are in some degree modified with regard to forests. So far as the inhabitants of rural districts obtain fuel from the communal possessions there is no reason to object to local management. But in modern times the need of husbanding and developing the national forests has become too important an end to be surrendered to the care of persons whose views are from the nature of the case certain to be limited to a particular district and to present advantage. The result has been a very general centralisation of management in this respect. France, Italy, Switzerland, and the United States have all dealt with the matter as one for the central government. The Swiss cantons, so jealous of their autonomy, have not refused to surrender the control of forests to the Federal government. All the conditions that we noticed in a former chapter as tending in favour of central management are in operation here. General interest, need of trained intelligence, and of unity of control make it expedient to continue the policy of centralisation.

CHAPTER III

THE INDUSTRIAL DOMAIN

§ 1. In the preceding chapter the gradual decay of state revenue from landed property has been considered. Special circumstances may preserve a comparatively large amount of agricultural possessions in the case of some nations, but so long as the present system of private ownership and free competition continues—and it is only to societies resting on that economic basis that attention need be directed—no large part of the State's resources can, speaking generally, be obtained through the rent of public lands. The universal tendency exhibited in countries so widely separated in all respects as England, the United States, and India is towards a relative, or even an absolute, decline in the revenue derived from this form of receipts.

Another class of public property does not so clearly show the same movement. The industrial domain, if it has been contracted in some directions, has been enlarged in others, and its position in state and public economy is deserving of the most careful examination. For this purpose it is best to take the leading groups of industrial activity, beginning with that which belongs to extractive industry, and is consequently nearest to agriculture and forestry.

§ 2. Besides the retention of agricultural land and forests, the State has in most societies regarded mines as belonging to itself. Thus the famous silver mines of Laurium were an important source of revenue to the Athenian people, who let them out on lease. Rome retained its salt mines

and monopolised the sale of the product. As the Roman dominion extended by conquest the mines of the provinces came under its control. The modes of management applied were different in respect to the various minerals, gold and silver mines being directly worked by the state slaves, and other mines conceded on lease or abandoned to private working, subject to a tax proportional to the produce.

The mining laws of mediæval Europe were affected by feudal ideas; they placed the right over minerals in the 'Lord' or '*Seigneur*,' and the influence of this system can be traced at present in the English law as to gold and silver mines. The desire to encourage mining industry, and the need of gaining revenue for the sovereign, both tended to restrict the rights of landowners with respect to what lay beneath the surface. Hence the system of 'free mining,' under which the discoverer was entitled to open a mine against the landowner's wish, subject to the payment of royalties to the State (*Bergregal*), became usual.[1] Notwithstanding this growth in Continental States of a separate property in mines, some countries retained much of their mineral wealth as public property, more particularly where the landed domain also was extensive. The various parts of the German Empire are noticeable for their state mines, though the distribution of these sources of wealth is far from uniform. Prussia owns coal, iron, lead, silver and copper mines, which (including the value of the partially worked-up products) contributed in 1901–2, 192,316,000 marks *gross* revenue. Austria, Russia, Spain, and India also possess some mines as state property, though they are practically conceded to private owners. The financier is not much concerned with this part of the public possessions, as the *net* revenue obtained is small. The mines and mining works of the Prussian government in 1901–2 gave only 33,794,000 marks (about £1,690,000) as their *net* yield. Salt, which in many countries contributes very largely to the public resources does so through taxation.

[1] Roscher, *Handel und Gewerbfleiss*, § 180.

Whatever be the net return from mines, it should—economically considered—be divided into two parts, (1) the rent of the mine, and (2) the profit on its working, including the gain of elaborating the raw material obtained from it where this is done at the mine. The former is essentially the same as the rent of land, though possessing some peculiarities due to the exhaustible nature of mineral products, and is generally levied in proportion to the gross yield. Without state ownership it might be applied as a special tax on private owners of mines.[1] The second element is plainly the result of the employment of capital, and should therefore comprise both ordinary interest and employer's gain. The use of capital in mining is a highly speculative one, being most uncertain in its returns. The receipts from the Prussian mines have varied much, and of course are dependent on the prices of the minerals produced.[2] It therefore seems desirable to give up this source of revenue by selling the mines to private individuals or companies, and applying their price to the reduction of debt; and from the financial point of view the wisdom of the policy of sale is indisputable. The continuance of mines as state property is due partly to the survival of the older forms of public economy in which taxation was subordinate to quasi-private receipts, and partly to views of economic policy. The danger of mineral supplies being worked in a reckless and extravagant manner without regard to the welfare of future generations, and the dread of combinations by the producers of such commodities as tin, copper, and salt, with the aim of raising prices, have both tended to hinder the alienation of state mines. There are fortunately other and more effectual methods of warding off these by no means imaginary evils.[3] The disposal

[1] On the nature of mining rents see Sorley, *Mining Royalties*; also Marshall, *Principles*, i. 491.

[2] Wagner, i. 609.

[3] Jevons, *Coal Question*, 354 sq. The 'rings' formed in the articles mentioned in the text illustrate the danger, but in all cases the originators have suffered heavily.

of state property does not carry with it a surrender of the right of state regulation where public interests require it. It is also possible to retain the ownership (*dominium*) in the State, giving long leases to the capitalist workers, by which system the risk of market fluctuations is in a great measure avoided; or, finally, the net receipts from mining industries may be specially taxed.

In one case the policy of sale may not be a wise one. When the particular product of a mine is taxed, the necessity for supervision compels the public officials to watch the process closely; and under such conditions to place the whole business in the hands of the administration or of a powerful company may be the best course and prove the least inconvenient to all concerned. The principal example is in the case of salt, which is taxed in most countries, and monopolised by the State in some. Where the supply is obtained from mines there is an obvious advantage in keeping them in the hands of the State.[1]

§ 3. The modern State has not confined its activity to extractive industries. In the seventeenth century, France started some of those model manufacturing establishments which continue to the present, and possess so varied a character.[2] The German States followed a similar course, and during the eighteenth century many artistic industries were founded under official management. The object was not financial; it was rather to supply a standard for private producers and to discharge the functions now supposed to belong to exhibitions. The more costly products were intended for court use, or as gifts to foreign princes.[3]

This class of state factories has preserved the original

[1] See Bk. iv. ch. 6 for the salt tax.

[2] 'On ne se fait pas une idée de tout ce que fabrique l'état en France; il fait des tapis (les Gobelins), des porcelaines (Sèvres), des cartes au Bureau d'état major, des gravures (au Louvre), de l'imprimerie (à l'Imprimerie Nationale): il fait des boîtes d'allumettes, des cigarettes, il élève des chevaux et des poulains dans ses haras; il fait du vin à l'école d'agriculture de Montpellier.'—Gide, *L'École Nouvelle*, 18.

[3] Wagner, i. 623.

type, and is important only as giving examples of superior work or supplying some state need for a certain commodity. But though financial aims are not prominent in this department of public economy, there are opportunities for realising a moderate revenue by careful management and securing a superior class of products.

The latter consideration becomes of great importance when we pass to the method of supplying the larger public services such as the military and naval forces. The difficulty of deciding on the best mode of meeting the manifold needs of modern armies and fleets is chiefly due to the conflict of financial and technical reasons.[1] As we shall see, there are strong economic and financial objections to direct manufacture by the State. But in some cases it is essential to secure a high standard of excellence in the products. Guns that will not go off at the right time and bayonets that bend under pressure are dear at any price; and state establishments for the production of these articles are defended on the ground that in no other way can goodness of quality be guaranteed. The state clothing factories and flour-mills have been supported by like arguments, since it is assumed that complete supervision of private contractors is practically impossible. On purely financial grounds state industries of the kind are open to serious criticism, owing to the very defective system of keeping accounts which is characteristic of such establishments. The amount of invested capital is hardly ever properly estimated; receipts that should go to capital are assigned to revenue, and expenditure that ought to be met from revenue is defrayed from other state funds or by borrowing.[2] To

[1] The Report of the Committee on 'War Office Organisation' (Cd. 580–581) brings out forcibly the difficulties of this question, and particularly those surrounding the system of audit and the estimation of the cost of production. See particularly the evidence of Mr. Harris (pp. 380–7).

[2] This defect in state industrial management is very forcibly exposed in Cobden's last speech in Parliament (July 22nd, 1864): 'Throughout the inquiries before Parliamentary Committees upon our Government manufactories, you find yourself in a difficulty directly you try to make the gentlemen at

meet this evil it seems best in a developed industrial community to trust to private enterprise for the supply even of warlike implements. The growth of such factories as those of Elswick and Essen ought to enable Government to dispense with the troublesome institutions that require so much attention and vigilance to prevent the grossest abuses. Where there is not a fully grown system of industry it may be necessary to keep up state arsenals, dockyards, and factories, to supply wants that would otherwise remain unsatisfied, and it is, perhaps, partly to this earlier condition that we owe the erection of the state industries in question. Moreover, the possibility of keeping down prices, by having an alternative source of supply in the not unknown case of there being only one private factory in existence, may be allowed in favour of state industry, though against it there is the risk of political corruption in towns that are largely supported by public outlay. Admitting then that the State's manufactories for its own use are necessary only in the earlier stages of development, and ought to diminish as society advances, we may go on to assert that the same proposition is true of public industry in general. The government of a backward country may rightly undertake works that would be quite uncalled for in more advanced nations. British India gives us numerous illustrations. The most promising agricultural industries have been taken under state management and costly experiments have been tried. The best available evidence, however, leads to the conclusion that the greater

the head of these establishments understand that they must pay interest for capital, rent for land, as well as allow for depreciation of machinery and plant.' *Speeches* (popular ed.), 301–2. 'The accounts rendered of this clothing department are most fallacious. I find that about £15,000 a year for fixed charges and interest of money have never been brought into the accounts at all, and that there is no allowance for rates and taxes,' *ib.* 304. Cp. 'Although the victualling and other offices that carry on manufactures produce accounts by way of showing that they make them cheaper than they can be got by contract, this does nothing towards supporting their case, because their accounts are all kept in so imperfect a manner that they cannot be relied on.' Parnell, *Financial Reform*, 162–3.

part of these well-meant efforts have been unsuccessful, and they have in some instances been abandoned.[1]

§ 4. Though any very large system of state-directed industries is not likely to be a financial success, and is besides open to other weighty objections both social and political, there are some exceptions to the general statement. There is no validity in a plea of *laissez faire* set up in opposition to special cases of state industry, when it can be shown that the interests of the community will be furthered by interference. The rule of non-intervention is nothing but a generalisation from experience, and holds good so far only as experience supports it. Where special reasons justify the action of the public power there is no ground for objecting to its employment. To avoid the opposite and more dangerous extreme, we should add that the advantageous conduct of certain industries by the State is no argument in favour of extending its activity to other and dissimilar cases.[2]

In addition to the direct supply of the needs of the public services, which in some cases is a good ground for the State undertaking industrial functions, there is the important class of cases in which the production of certain articles is subject to heavy taxation. In such cases the placing of the absolute control of the process of production in the hands of a state department may be a financial necessity, as the only effectual remedy against fraud and evasion. The French tobacco manufacture is probably the best example of this system, which is also exemplified in the Bengal opium regulations. But the large receipts obtained from these industries are not in reality industrial. Scientifically speaking, they are a part of the revenue raised by taxation, the state monopoly being only a particular form.[3] The ordinary gains of a business are all that

[1] Hunter, *Imperial Gazetteer of India*, vi. 515–6.

[2] These cautions are particularly important as dealing with the very practical question of the proper limits of municipal trading.

[3] See Bk. iv. ch. 6; and, for particular forms, 'Taxation through Monopoly,' *Economic Journal*, i. 307–325.

should be credited to it as 'earnings,' unless the extra amount is due to the superior efficiency of public management.

§ 5. The remaining cases, where the industrial action of the State may possibly be useful and has in practice been largely applied, may be grouped under two heads, according as they exhibit specially one of two characteristic features; viz. (i) those industries in which there is a tendency to the creation of monopoly, or in which the establishment of monopoly is likely to prove economically advantageous, and (ii) the large and important industries that deal with communication and transport. This classification is unfortunately not completely distinctive, since the last group in many instances exhibits the features of the first-mentioned one, but it is sufficient as a guide in discussing the principal points of interest.

(i) The first group is not easily characterised and separated, but there are some general marks that may be taken as common to all the industries in question; they are:—

(1) The products are much required, and in some cases absolute necessaries, or of high sanitary importance. (2) They are connected with special localities, and situation is an element in their advantages. (3) They are usually subject to the 'law of increasing returns,' and thus concentration and unity in management tend to cheapen the product. (4) Competition is not steadily operative even where no legal restrictions are imposed.[1]

On coming to collect the industries that belong to this group, we further notice that they in great measure fall within the domain of local rather than that of general government, and are moreover chiefly due to the conditions of city life. The oldest, and one of the most important, is the supply of water. Under ordinary circumstances this

[1] The nature and characteristics of these industries are discussed by Farrer, *State and Trade*, 68 sq.; also cp. H. C. Adams, *Relation of the State to Industrial Action*, and *Science of Finance*, 263-4.

indispensable commodity is valueless in the economic sense, and has usually been the stock example in economic text-books of objects that possess utility, but are not wealth. The growth of population in certain confined areas at once creates a greater demand than can be supplied from natural sources, and at the same time pollutes that limited amount. Fresh supplies must be obtained from a distance, and often necessitate heavy outlay. In earlier times, this of itself made it incumbent on the State to do what no private individuals' association could accomplish, a policy extensively carried out by the Romans. In the modern period, the business of water-supply to cities has been placed in the hands of private companies, who have invested large amounts of capital for the purpose. The rise of the sanitary movement of the nineteenth century, and the danger of monopoly on the part of the holders, have led to an extension of public activity, and to the purchase of waterworks by the municipalities. This tendency has been clearly shown in the United Kingdom during the last thirty-five years. Of the larger towns, London, Bristol, and Newcastle only are supplied by private companies, and the purchase of the London water companies is actually proposed. The receipts for water-supply by English local bodies in 1897–8 were over £2,600,000. In the United States there has been a like movement. Out of 135 towns of about 10,000 inhabitants, 91 had municipal waterworks, the remaining 44 being supplied by companies. Continental cities also, in many cases, have acquired full charge of this industry: this is true of Berlin, Paris, and Vienna, not to mention smaller towns.[1]

[1] For the position of English municipalities, see the annual *Reports of the Local Government Board.* For the United States, *The relation of modern municipalities to quasi-public works* (American Economic Association, ii. No. 6); also Ely, *Taxation in American States and Cities*, 47 sq. For Germany, Wagner, ii. 160–4; Roscher, § 158. Also Leroy-Beaulieu, *État Moderne*, 228 sq.; Say, *Dictionnaire d'Économie politique*, s. v. 'Eau dans les Villes.' For an instructive comparison between Berlin and Paris, see Rowe, *Gemeinde-finanzen*, ch. iv. In the last few years there has been a great development

The business of lighting has not as yet been so largely entrusted to public agency, but several leading British towns have acquired their gasworks: Manchester, Birmingham, Leeds, Glasgow, Edinburgh, and Belfast may be mentioned as examples. The United States have hardly entered effectively on this branch of state industry. The most remarkable example of municipal gasworks was that of Philadelphia, where they only had taken over the business in 1887, but abandoned this system in 1897 by leasing the works to a company for the term of thirty years. This change in policy was the subject of much discussion and somewhat severe criticism, as it seemed to be opposed to the prevailing tendency towards extension of public control.[1] There are a few other cases of municipal management in the smaller American towns. Out of the forty-four largest German towns, twenty-nine (including Berlin, Leipzig, and Breslau) own their gasworks, while Paris is supplied by a privileged company.[2]

Drainage and the removal of refuse, as well as other sanitary arrangements, are usually regarded as a public function involving expense, though scientifically these operations are on exactly the same plane as the supply of water and light, and might be carried on as a private business; but in practice, as the service is a general one, its cost is defrayed from taxation.

The actually existing forms of these public industries, and the line of development that they are following, are easily explicable. The rapid increase of public waterworks is due to the great importance of a pure supply of that necessary, to the large quantity of it that is required for

of municipal industries, specially in connexion with electric lighting, and very keen controversy as to the expediency of this movement. See the evidence taken by the Committee on 'Municipal Trading.'

[1] See the articles on the subject by L. S. Rowe, *Annals of American Academy*, xi. 301–23; and W. S. Lewis, *Quarterly Journal of Economics*, xii. 209–24.

[2] In addition to the works given in the preceding notes, see James, *The Modern Municipality and the Gas Supply;* and Farrer, *State and Trade*, ch. II.

public purposes, and finally to the absence of invention in the industry. Lighting, while it possesses some of the features just mentioned, is very different in the last respect. Until the contest between gas and electric lighting is closed, the acquisition of either of these industries will be a financial risk that no prudent body will care to incur.[1]

§ 6. Without dwelling on further details, or considering the politico-social aspect of the movement, we need not hesitate to say that a new public domain, yielding large gross returns, has within the last fifty years become established in most civilised States. The gas and water works of the United Kingdom under municipal working give an estimated yield of about £7,000,000, and the similar German industries afford a considerable net return to the local budgets.[2] It is quite possible that in the present century such industries will give substantial aid towards meeting the heavy expenditure that town administration requires.[3]

On the other hand, there are some financial aspects of the case which reduce this apparent gain to much more moderate dimensions. The purchase or construction of the needed public works has involved municipal governments in heavy debt. Thus the returns of English municipalities for 1897–8 show an outstanding debt for waterworks of £41,578,000, and of £15,800,000 for gasworks; there is further a debt of nearly £,3,000,000 for market buildings. Adding these figures together, we get over £60,000,000 of actually existing debt, besides what has been already paid off.[4] According to the United States Census of 1890

[1] 'Waterworks are generally owned by our municipalities, and gasworks rarely.' Ely, 48.

[2] In 1891–2 Berlin obtained the following net profits:—

Waterworks	1,896,056 marks.
Gasworks	5,320,450 ,,

Making 7,216,506 marks, or over £360,000. Rowe, pp. 87, 90. For 1897–8 the gasworks yielded about 5,000,000 marks.

[3] Leroy-Beaulieu, i. 110.

[4] The city of Berlin owed in 1892 nearly 75,000,000 marks (£3,750,000) on account of its gas and water works. Rowe, 191.

about £38,500,000 of local indebtedness was incurred for waterworks. The interest on these loans has to be deducted from the gross receipts of the industries before a full estimate of their financial position can be made; and though the actual debt-charge is enhanced by the sinking funds attached,[1] there is on the other side the cost of renewing the works after a period. Another deduction has also to be made. On the assumption that the different public industries were left open to private enterprise, it would be possible to tax their profits, or, as most of these industries are monopolies, to levy a special charge on their gains. The right of supplying a large city may be sold to a company or let for a term of years, and the revenue thus obtained without risk or trouble applied to the use of the municipality. By granting a long period, with the ultimate reversion to the local governing body, a large revenue would be provided for the future, and the difficulties of public management escaped.

As in the case of mines and their products, any charge for municipal services that exceeds normal profit must be regarded as taxation. The profit of capital expended on public works is a part of the earnings or industrial receipts: so is any further amount gained by the low interest at which well-managed towns can borrow, or the savings that monopoly, with the consequent check to waste by competition, may cause; but any additional charge for the supply of water, gas, or other services is in fact a tax on the consumers or users of that service.[2] We have noticed before this mingling of earnings and taxes in public economy. Another financial evil may possibly result from municipal industries. Instead of taxing the consumers by heavy rates, the administrators may reduce the charges below the profitable level, and so give what is in fact a bounty on the commodity at the expense of the taxpayers. Where the article is required by the poorer members

[1] See Bk. v. ch. 8, for an examination of local indebtedness.

[2] Cp. Cohn, § 458.

of the community, the temptation to adopt this course is very strong, but it really involves the transfer of the industries so dealt with to the head of expenditure; from being a source of revenue they become a charge on the municipal budget, and their development only adds to the public burdens.

§ 7. (ii) The second group of industries leads us back to the finance of the central power, and includes amongst its ranks the best known and most generally accepted of all state employments. The Post Office has been regarded, even by the older economists, as an exception to the general rule against state interference in trade and industry. 'It is, perhaps,' said Adam Smith, 'the only mercantile project which has been successfully managed by, I believe, every sort of government,'[1] and his opinion has been accepted by all his English followers, none but the extremest advocates of state abstention ever questioning the public management of this department.

State postal service originated in the claim of the sovereign to monopolise whatever affairs closely affected public interests, and in the need of communication between officials. Its development has been the same in its general features in all European countries. At first the service was rendered by private persons, or by some specially privileged body (*e.g.* in France the messengers of the University of Paris), and was finally taken by the State, though in most instances it was farmed out to a company.

The English Post dates from Charles I. (there being little evidence for the earlier dates of Edward IV. and Henry VIII.), and became a strict monopoly during the Commonwealth. After the Restoration, it was bestowed on the Duke of York, who retained it on his accession to the throne as James II. in 1685. The net annual revenue was at that date about £50,000.[2] The growth of revenue during the eighteenth century was steady, and various

[1] *Wealth of Nations*, 344.

[2] Macaulay, *History of England*, ch. 3.

improvements, such as the introduction of mail-coaches in 1784, improved its position. The invention of railways and steamships further aided the expansion of postal service, until in 1840 the introduction of the penny letter-post, on Rowland Hill's proposal, widely distributed the advantages of cheap communication. Without in the least denying the wisdom of this reform, it should be said that its real financial result was not what is popularly believed. So far from improving the net revenue of the service, it actually lowered the gross revenue, and so far reduced the already deficient income of that period. In 1839 the gross revenue had been £2,390,000, and the net revenue £1,630,000. In 1840 the former fell to £1,360,000, and the latter to £500,000, showing a loss of over £1,130,000; and this loss continued for several years: the gross receipts did not exceed those of 1839 till 1855, and the net revenue did not recover its losses till 1864. Taking into account the growth that would have taken place even under the older system, it is plain that the immediate adoption of the penny post involved a sacrifice of financial resources.[1]

Even during the last thirty years, though the mass of business has grown enormously, the net receipts have not shown a proportional increase. They amounted in 1872–4 to £3,060,000, in 1883–4 they had risen to £3,222,500, in 1893–4 to £3,749,000, and in 1901–2 to £3,999,000.[2]

The French Post Office was instituted by Louis XI. in 1464, and carried on irregularly, till in 1627 the service was better organised and improved. The business was farmed out in 1672, and the competition of the agents of the University of Paris was prohibited; the yield increased

[1] The reform is described by one of the most sober of English statesmen as 'a measure of undoubted social and general advantage, but extremely inconvenient in a financial sense.' Northcote, *Twenty Years of Financial Policy*, 9. It was opposed at the time by J. R. McCulloch; see his *Taxation and Funding*, 327–32. For an examination of the use of the Post Office as an agent for taxation, see Bk. iv. ch. 8.

[2] These amounts do not include the telegraph service, or the payments for packets

from 100,000 livres in 1661 to 1,220,000 in 1677, and 1,400,000 livres in 1683. In 1699 the postal income was 2,800,000 livres, in 1750 it had increased to 4,500,000 livres, and in 1788 it reached 12,000,000 livres. The method of farming, so common under the *Ancien Régime*, made it in fact a monopolised private industry, on which the State levied a gradually increasing rent.

The Revolution separated the carriage of letters from the other duties of the old '*Poste*,' and in 1792 placed the former under the direct management of the State. The heavy financial pressure, and the general mismanagement of the revolutionary period, caused a great increase in the charge for letters, destroyed the receipts from the business, and even left a deficit on the working. The postal service did not gain much during the Consulate and Empire, but several improvements were introduced after 1815. The rates were better adjusted, and the increased facilities of transport allowed of a better service. The example of England, whose adoption of the uniform penny post attracted much attention and was eulogised by Bastiat, led to the establishment in 1848 of a charge of 20 centimes (*2d.*), which has been raised to 25 centimes in 1850 and again in 1871, restored to 20 centimes in 1854, and finally reduced to 15 centimes (1½*d.*) in 1878.[1]

The same fact of financial loss through reduction presented itself in France in 1848 as in England in 1840. The gross revenue fell from 45,000,000 francs to 32,000,000 francs in the first year after the change (1849), and only recovered the earlier amount in 1855.

The postal history of other States is very similar. Germany, owing to its political disorganisation, was in part served by the house of Thurn and Taxis, which managed the carriage of letters for several of the smaller States. The Prussian post began in 1646, and was under direct state

[1] For the French Post before 1789, Vignes, *Traité des Impôts*, i. 476 sq.; Clamageran, ii. 658; iii. 43, 232, 293, etc. For its later history, Leroy-Beaulieu, i. 645 sq.; De Parieu, iii. 287 sq.

administration. Its net yield in 1685 was less than 40,000 thalers; by 1740 it had increased to 220,000 thalers. The financial necessities of the government caused an increase in the tariffs, and in 1806 there was a clear surplus of 667,000 thalers. The amount in 1856 had risen to nearly 1,760,000 thalers, and in 1862 to over 2,200,000 thalers. The events of 1866 and 1870-1 changed the Prussian post into that of the German Empire—Bavaria and Würtemberg only retaining separate establishments. The net revenue of the imperial post was, in 1874, 5,000,000 marks (1 thaler = 3 marks); in 1879, 17,500,000 marks; in 1892–3, 21,000,000 marks, and in 1901–2, 40,320,000 marks.

The postal systems of Austria, Russia, Italy, and those of the smaller European States need not be examined in detail. Nor does the postal development of the United States, India, and the Colonies present any special features of interest. One general fact is the smallness of the revenue obtained. England, France, and Germany are the only countries that derive a substantial amount from the postal service.[1]

§ 8. The so-called 'Post Office' is in fact a collection of different, though connected, industries. The earliest state posts in both England and France carried passengers as well as letters, and this function lasted in the latter country till the Revolution, when the state passenger service became a separate organisation, and endured till 1870. But the conveyance of patterns, books, newspapers and small parcels forms an extensive part of the postal service, and is the least profitable side of its endeavours. The rates for these separate classes are below the ordinary letter-charges, since otherwise the amount of business would be much reduced. The State is compelled to adopt the principle familiar to railway managers of charging what 'the traffic will bear,' but it necessarily obtains very little over the cost of its operations. So far as the conveyance of parcels and newspapers is concerned, the English Post

[1] Wagner, ii. 142; Cohn, §§ 293-6, also *Finanz-Archiv*, x. 765–6.

Office does not possess a monopoly, and is therefore a true industrial agency, whose earnings contain no tax element. The German post has specially developed the conveyance of parcels, a part of the business which is left entirely to private companies in the United States, and is a comparatively recent addition in England (only since 1882).[1]

To secure a proper adjustment of rates on the many classes of articles, and to duly apportion cost and service to the several items, is beyond doubt a most complicated problem. Such solutions as have been reached are for the most part empirical, and are the outcome of innumerable changes. The mere recapitulation of the diverse charges of the various state letter-posts would fill many pages with figures that could hardly be explained on any definite principle. There are, it would appear, three elements that might be taken into consideration, two of which depend on definite physical facts, viz. (1) the weight of the communication or document; (2) the distance over which it has to be carried; and (3) its nature; to which (4) the mode of conveyance may be added. The first is at present the basis of the charge for letters. The second element has lost most of its importance. Since 1839 the question of distance has entirely disappeared in the postal charges of the United Kingdom. A letter from Penzance to Wick pays the same as one posted to a person residing in the same street as the sender. France has with one exception adopted the same policy since 1848, and the United States have also a uniform rate, practically the same as that of England (2 cents). The reason for this at first sight curious system is found in the fact forcibly urged by Rowland Hill, that the actual cost of carrying letters is small enough to be ignored. At the rate of one penny per ounce, a ton of letters all up to the full weight would produce almost £150, while the mere cost of conveyance would certainly not be £5, or one-thirtieth of the receipts.

[1] Another side of the Post Office, its dealings with money, belongs to 'Banking,' and will be considered under that head. Bk. ii. ch. 4, § 2.

The real charges are those of collection and distribution and the maintenance of offices, the cost of which is equal on all letters. The uniform charge irrespective of distance is thus easily explained, and proved to be sound as well as equitable. It is in the extension of this principle to international postage that the greatest advance in the future may be expected.[1]

'One of the principal distinctions now turns on the character of the articles transmitted. Circulars and postcards would not bear the same charge as ordinary letters. The transmission of newspapers gives a yet smaller fund of utility on which to levy a tax, and is affected by the competition of carrying agencies. The result is shown in the lower halfpenny rate. The mode of conveyance might be used as a measure of the relative value of the service, speed in transmission being a very important part of the advantage of communication ; but in fact this test has been little used.

§ 9. The question of the retention of the postal business by the State is hardly an open one. Long experience seems to have decided altogether in its favour. No country has adopted the method of private industry as regards letters, though the state parcel post is not so general. The reasons for this remarkable unanimity are to be found partly in the facts of governmental administration, partly in certain special features of the employment. Before the rise of the economic schools that opposed industrial action on the part of the State, the method of public postal service was firmly established, and was seen to give, on the whole, sufficiently satisfactory results. It therefore escaped the hostile criticism that economists freely bestowed on the less efficient public departments. Mr. Herbert Spencer himself has hesitated to condemn the continuance of the

[1] The Bern Convention of 1875, by which the uniform rate of 2½d. per ½ oz. was settled as the international postage charge for most civilised nations, and gradually extended to others, has been a great advance. India and the Australasian Colonies have since the opening of 1891 obtained the same rate with England.

English Post Office. The peculiar nature of the service supported the evidence of facts. It requires as a first condition that the agency shall cover the whole territory to be served, or be universal. Next, it must be uniform and regular, and conducted on a definite routine; and, thirdly, the necessary capital is very small in proportion to the recurring expenditure and receipts. All these conditions favour state management, while its close connexion with everyday life secures a constant supervision on the part of the public, who are the consumers interested in the efficiency of the service.[1] It is, therefore, expedient as a matter of policy to place the work in the hands of the State, and the bestowal of a monopoly is justified on the double ground that otherwise private agencies would compete for the more profitable parts of the business, leaving the supply of sparsely peopled and backward districts to the official post office, whilst the waste involved in rival establishments would hinder the reduction of rates below their actual level.

On the purely financial side the gain from the service must generally be a small one; the return for capital employed is little, and the only remaining element would be the economy that results from the application of monopoly, and the consequent unity of the service. Any further charge is really a form of taxation, and requires to be tested by the rules applicable to that mode of procuring revenue.[2] The resources to be obtained are in any case not

[1] Adam Smith noticed these conditions: 'The capital to be advanced is not very considerable. There is no mystery in the business. The returns are not only certain but immediate,' 344; cp. the fuller account of Jevons, *Methods of Social Reform*, 277–80; also Wagner, i. 654–5.

[2] This combination of different elements in the postal revenue has led to a curious diversity in the classification made by financial writers. Adam Smith considers it under the head of 'Funds which peculiarly belong to the sovereign. Leroy-Beaulieu (Bk. ii. ch. 12), De Parieu (iii. 285), and Cohn (§ 77) place it under Taxation. Roscher (§ 28) practically follows Adam Smith. Vocke (*Finanzwissenschaft*, 36) treats it as an 'economic monopoly.' Stein (ii 315 sq.) places it in the list of prerogative rights *regalia*); while Umpfenbach (§§ 61-3) and Wagner (ii. 141 sq.) regard the postal revenue as being derived from 'fees' (*Gebühren*). These differences are due to the attempt to reduce to

important, though good management may easily prevent a deficit, and unduly high charges will by their reaction on industry prove seriously detrimental to other financial resources.

§ 10. The telegraph as a state business forms a natural appendage to the postal system. It is generally connected with it, owing to the resemblance in the work to be done. There are, however, some serious differences. Unlike the letter-post, telegraphic work has been successfully carried on by companies, and international telegraphy is still largely in their hands.[1] The capital expenditure is much greater in the case of the telegraphs, and therefore leaves room for that tendency of official bodies to confuse capital and revenue, which we have already noticed,[2] and which is so detrimental to sound finance. Not only is the original cost of establishment or of the purchase of pre-existing rights comparatively speaking large, but incessant renewals and extensions are required in order to meet wear and supply new demands. The saving by unity of management is, besides, not so great, and the cost of transmission

simplicity what is in its nature complex, and are therefore necessarily failures. J. S. Mill (Bk. v. ch. 5, § 2) distinguishes, as in the text, between the industrial and tax elements. The question of the true nature of postal revenue is discussed at length in the *Memoranda on Classification and Incidence*. The prevailing view agreed with that given in the text, but the answers of Professors Sidgwick and Edgeworth suggest the necessity of considering the loss to the society in consequence of the state monopoly through the destruction of 'consumer's rent.' (see pp. 100 and 127). Sir R. Giffen and Mr. Cannan argue that the gross postal receipts should be regarded as taxation, but this is obviously incorrect. The former writes, 'The postage of letters is a tax on letters—*taxe des lettres* it is called by French economists' (p. 94). This, however, ignores the fact that *taxe*, as distinguished from 'impôt,' and like the Italian 'tasse,' is rather a 'fee' or 'due' than a 'tax' in the English sense. If the gross receipts of the Post Office are to be called taxation, it would follow that the purchase of the English railways by the State would transform railway rates and fares into taxation, and thus nearly double the tax revenue. See for a series of acute but over-subtle distinctions, Seligman, *Essays*, 295 sq.

[1] 'The present mileage of submarine cables is 152,000 miles, of which 90 per cent. has been provided by private enterprise and 10 per cent. by the various governments.' *Times*, July 21st, 1894.

[2] § 3, *supra*. A grave oversight was committed with regard to the English telegraph account, by which £800,000 was spent without sanction.

forms a larger proportion of the expense, which increases with increased work more rapidly than in the letter-post.

All the circumstances suggest that state telegraphy is not likely to prove financially successful, and such is apparently the result as shown by experience. The intermingling of postal and telegraphic business makes it hard to establish this proposition, but where a strict separation is kept up the telegraph balance is generally on the wrong side. The English state system has suffered financially, first from the excessive purchase money given to the companies who held the business, and secondly through the pressure on Parliament for lower rates, as shown in the adoption of sixpenny telegrams.

If full power to regulate its rates on economic principles be given to the department, there seems to be no reason why it should not at least meet expenses, including interest on capital, or perhaps give a small surplus, sufficient to clear off the first charges in a series of years. Behind the fiscal question there remains the more difficult one of the effect of state management on the development of improvements. To retard the progress of an essential modern auxiliary to commerce for the sake of adding a sum to each side of the national budget is not a desirable achievement. The dealings of state agencies with new inventions are the worst blot on public administration, and it seems that there is this risk in the state telegraphs, that though they are quite up to the standard at their inception, they almost insensibly fall behind as it advances with growing knowledge. This consideration belongs to economic policy rather than finance, which, however, suffers from any hindrance to commercial expansion and is certainly not likely to gain by state telegraphy.

§ 11. The agencies of transport and the different facilities for the movement of goods have in modern times acquired much greater prominence, and have to some extent come to occupy a different financial position. Adam Smith regards the maintenance of roads and canals

as one of the duties of the State, requiring expenditure that ought to be defrayed out of the special receipts obtained from the users. His recognition of the so-called 'fee-principle' (*Gebührenprincip*) is qualified by his discussion of the taxes on communication, and is further weakened by the modern development of the transport system.[1] To understand the financial position of the industries in question, we have to separate the different forms and examine them in order.

The maintenance of ordinary roads can hardly be regarded as a quasi-private industry. It is a part of the functions of the State, and preferably of the local governments. The principle of particular interest assigns this task to the smaller divisions, unless in the case of great main lines of traffic, but in no way does it fall within the industrial domain, unless the antiquated method of tolls is employed, and even then such charges have more resemblance to taxes.

The canal system has better claims to treatment under the present head. Private companies have in many instances reaped large profits from this form of investment, and there seems to be no reason why the State should adopt a different policy when it is the owner. In practice the usual tendency has been to keep the rates down to the amount necessary to cover expenses and meet the interest on the capital charge. The introduction of railways has put an additional strain on the canal finances, since rates have to be kept below those of the more rapid competitor, until finally in many cases all dues have been abandoned, and the canals have been maintained at the public expense. Such has been the position in France from 1880, when, in opposition to expert opinion, the last remnant of the canal dues was abolished. The Erie canal constructed by the State of New York, which at first gave very large surpluses, had to be relieved from all tolls in 1882. The German rates have also been lowered, and at

[1] *Wealth of Nations*, 303 sq. ; cp. 379.

the same time large expenditure has been incurred for new works; so that it appears that no assistance to the national or local revenues can be derived from this source so long as present industrial conditions continue.[1] The system of purely gratuitous service is certainly unjustifiable. A canal ought at least to pay its working expenses, otherwise its maintenance is a direct loss. The charges needed for this purpose would come from the utility that it affords, and the assumed impossibility of levying them is a proof of the comparative inutility of the service.

With regard to capital expenditure the case is different. The tendency of all improvement is to displace fixed capital previously in use by newer and better forms, and state agencies cannot expect to escape this influence. But the existence of the danger is a good ground for seeking to get the maximum net revenue in the earlier years, in order to wipe off the capital charge, and in the period of decline for keeping the rates at the highest profitable level.[2]

§ 12. In social and financial interest and importance railways far surpass the other agencies of transport. The creation of the nineteenth century, they have contributed largely to promote its special characteristics. Existing political and economic arrangements depend for their successful operation on the modern railway system, supplemented by steamboats and telegraphs. Accordingly we need not be surprised to find that the principal financial problems of the public industrial domain centre in the treatment of railways. Every country has had to consider in what mode it might best utilise the invention, and in each the

[1] According to Professor Cohn, the expenditure of the Prussian Government on waterways for the years 1880–90 shows an annual average of £1,835,000 against annual receipts of £100,000. He declares that 'thus nearly the entire surplus of the railway administration is swallowed up by the waterways.' *Economic Journal*, iv. 544.

[2] Much stress has been laid on the indirect benefits likely to result from the abolition or lowering of dues on waterways by encouraging industry. This claim really amounts to the advocacy of a bounty, and should be judged on that ground. Cp. Bk. i. ch. 6. For the economic and financial position of canals, see De Foville, *La Transformation des Moyens de Transport*, ch. 7.

influence of national peculiarities and historical conditions has produced different effects. The railway legislation of England, France, Germany, and the United States affords many interesting examples of this statement.

Confining our attention to the financial aspects of the subject, two divergent modes of treatment are broadly contrasted.[1] The policy of England and the United States has been to regard railways as merely one particular form of industry taking a place beside banking, insurance, shipping, mining, or other companies, but dependent for any special privileges on the direct exercise of the legislative power. The railway company on its first appearance was regulated by enactments curiously similar to those devised for the earlier turnpike trusts and canal companies. The liberal laws of the various American commonwealths with reference to the formation of companies, while giving certain advantages to promoters, were based on the same principle. Such a policy reduced the public financial interest to a minimum. Railway companies were indeed taxed for local purposes in the same way as other proprietors of land and buildings. A passenger duty intended to balance the older stage-coach tax was imposed on them. Various corporation taxes were raised by the American States, lavish grants of land were given to new companies, some advances of money were made, but in all other respects the public powers and the railways were separate. The various changes of English and American legislation have not infringed on this complete isolation. The restraints of the Interstate Commerce Act and the Railway and Canal Act (1888) have had no financial aim or effect. They are confined to the field of economic policy.[2]

Continental countries have started from a different condition of things, and have all been willing to recognise a much closer connection of the State and the railways.

[1] For a clear statement of the opposed methods see Cohn, § 437.

[2] For an admirable account of the variations of American and English railway policy see Hadley, *Railroad Transportation*, chs. 7 and 9.

The earlier transport agencies had been under state direction. The carriage of passengers was one of the branches of the French post before the Revolution, and the administration of both roads and canals had been carried on by a state department. The German States had the same general conception, but did not possess the centralised organisation of France. There was thus a predisposing cause for the recent movement towards state railways, which has been encouraged by the ablest theoretical writers. The direct action of the State in the construction and working of railways has been restrained by economic conditions too potent to be set aside by legislation. England was the birthplace of the railway, and its mode of procedure had some effect on other countries, but the principal check was found in the absence of sufficient capital for the work. It was only by severe pressure on the English middle classes that the rapid progress in railway construction of the years 1845–50 was accomplished,[1] and the motive power was the extravagant hope of gain. No such force assisted Continental governments in procuring funds, and they were therefore compelled to fall back on the support of private companies, whose shareholders were actuated by the ordinary economic motives.

§ 13. The different circumstances of the different countries affected the railway system. France with its strongly unified government aimed from the first at establishing a well-arranged series of lines on a systematic plan, with the reservation of the ultimate property in them to the State. This course, when considered *a priori*, had much to recommend it. It preserved the routine policy of the administration as to the older communications, and it promised at the end of the periods of concession to the companies to add a valuable property to the public domain. The earlier concessions under the legislation of 1842 were for short periods, not in any instance exceeding forty-five

[1] Tooke-Newmarch, *History of Prices*, v. 367–9.

years. The result was, however, to hinder the investment of capital, and to gradually force more favourable terms from the Government. To encourage the construction of new lines a guarantee of interest was given to the older companies who opened them, and the time of the concessions was extended. Special legislation was applied to induce the construction of local railways either at the expense or with the aid of the local governments. The war of 1870-1 and its effects made the improvement of the service a matter of great interest. In 1878 some railways were acquired and worked directly by the State, and a plan for the creation of state railways on a large scale was proposed. Owing to the impossibility of procuring the necessary capital, a new arrangement was made with the companies in 1883, by which the state railways became only one, and that the least important, of the seven groups into which the main lines are divided.

The financial results are decidedly unsatisfactory. The surplus from the government group after the working expenses are paid is small (for the year 1885, 4,257,000 francs), and by no means equals the interest on capital, which for the same year (1885) was over 40,000,000 francs. The local lines are a further charge on the central and local governments, and they have been proved to possess little earning power. Under the various conventions between 1859 and 1883 large advances have been made in the form of guaranteed interest, amounting for the eight years 1867–74 to over 290,000,000 francs. As these charges are repayable out of the future increments of value, they have under the newer system been separated from the annual budget charge.[1] To state shortly the outcome of French railway policy on its financial side, we may say that as yet the expenditure of the State has been considerable, for which the returns so far have not been a sufficient recompense, but that the method of limited concession, which

[1] Say, *Dictionnaire des Finances*, 991, s. v. 'Chemins de Fer'; Stourm, *Le Budget*, 257.

checks the development of railway enterprise, and almost forces the State to give subsidies or guarantees, has the advantage of creating a large state property in the future. The terms of the six great companies who possess the main lines of France all expire between 1950 and 1960, when nearly 16,000 miles of railway will revert to the State, besides the new lines, amounting probably to about 6,000 miles, for which public money is by the arrangement of 1883 being gradually advanced. The net revenue of the French lines for 1899 was 690,000,000 francs, so that, without taking the prospects of increased revenue into account, there would be an addition of £27,600,000 annually to the state resources. Whether undue sacrifices have been made for the sake of this distant benefit is a difficult question to answer but we may conjecture that a simpler and more consistent method would have been better for French finance.[1]

§ 14. The earlier German railways were developed chiefly by state assistance or in some cases by state construction, but on no uniform plan. Each of the smaller territories formed its own railway system to meet local needs, without paying attention to the through lines of communication. Prussian railway policy was somewhat exceptional. Private companies were allowed to take part in the work of supplying needed lines, and guarantees of interest were given as encouragement. On military grounds several railway lines were constructed and worked by the State, and thus a basis was laid for the later policy.

The creation of the German Empire and the unification of its monetary and banking legislation could not fail to influence the position of the means of communication. State ownership and management were decided on, the only question of difficulty being the determination of the bodies who were to undertake the duty. At first the central or imperial

[1] For French railway policy see Hadley, ch. 10, and the articles 'Chemins de Fer' in Say, *Dictionnaire des Finances* and *Dictionnaire d'Économie politique.*

government was to have been the owner. When, in deference to the sentiment of the smaller States, this plan was abandoned, the Prussian administration proceeded to buy up the chief private lines and work them by state officials. The magnitude of this process, which commenced about 1870 may be judged from the fact that in 1878 the state-owned railways were about 3,000 miles against 11,000 miles owned by private companies. In 1893 the lines owned or worked by the State had 16,900 miles against 1,467 miles owned and worked by private companies. The smaller States have also purchased most of the few private lines in their territories. Hesse alone has a greater length of private than public mileage.[1]

So far as Prussia is concerned, the financial results have been extremely favourable. The prices paid for the purchase of the several lines were high, but nevertheless there has been a good surplus in each year after meeting all expenses and paying interest.[2] The services given to the imperial post by the railways form another gain, which is hardly ascertainable, since it is mixed up in the postal receipts, which are thereby increased. To obtain a clear revenue of over £15,000,000 is an undoubted proof of financial success, though it may partly be derived from limiting

[1] For the history of German railway policy, see Wagner, i. 707–13; Hadley, 203–8.

[2] The surplus over working expenses, the interest on debt, and the net gain are as follows :—

—	*Surplus over working expenses.*	*Interest on debt.*	*Net gain.*
	MILLION MARKS.	MILLION MARKS.	MILLION MARKS.
1882–3	138·1	95·7	42·4
1883–4	147·8	112	35·8
1884–5	186	140·5	45·5
1885–6	193·8	158·6	35·2
1886–7	225·2	157·6	67·6
1887–8	273·3	164·3	109
1889–90	278·5	165·5	113
1893–4	318·4		
1894–5	346·9		
1901–2	565·3		

the facilities for goods and passengers, and be in fact a tax on industrial activity. The great amount of public debt contracted as the purchase money of the private lines should be taken into account in considering the policy of Prussia. All pre-existing debt makes the terms of future loans more onerous, even when there are assets sufficient to meet the earlier charges, and it may be that Prussia's railway debt will injuriously affect her credit should she need it for war.

In the smaller German States the financial advantages of state ownership are not so great. In Baden the estimate for 1893 assumed a surplus over working expenses of 14,297,000 marks, while the interest and sinking fund on the railway debt was taken as 18,370,000 marks. Würtemberg is in a similar situation. The net revenue for 1893–4 was estimated at 13,000,000 marks, the interest on the railway debt being over 16,000,000 marks. The Bavarian railways have only now come to yield more than the interest of their debt, and the lines of Saxony just balance. The reasons for this relatively inferior position are not clearly established. The greater activity and the wider area covered by the Prussian railroads probably allow of more economical management than can be applied to the smaller lines. The system of state management is of longer standing in the other States, and it is possible that sufficient time has not elapsed for a proper judgment on the merits of the state railways of Prussia.

§ 15. Both Austria and Hungary have in recent years increased the number of their state lines. In consequence of the financial troubles of 1873, and to avoid the heavy payments for guaranteed interest, several leading lines were purchased by the State, though more than half remain in the charge of private companies. The surplus of the Austrian Ministry of Commerce, so far as the state railways are concerned, for 1902 is estimated at 39,220,000 crowns, which does not meet the interest on the railway debt. The Hungarian state railways also have been in an unsatis-

factory financial condition, but show an improvement, the surplus for 1892 being taken as 31,563,000 florins, a large increase over the preceding year.[1]

Belgium illustrates perhaps better than any other European country the operation of state and private railways. The earlier lines were created by the State with the object of developing the transit trade, for which the country was so well suited. Additional lines were afterwards constructed by private enterprise, which competed with the state railways and with each other. To avoid this struggle a large part of the company-lines has been purchased by the government, but with the unfortunate result of reducing the receipts below the profitable point. In 1870, before the era of purchase, the surplus was nearly 20,000,000 francs, and the interest on debt nearly 13,000,000 francs, giving a net gain of almost 7,000,000 francs. Ten years later the surplus had risen to 45,750,000 francs, but the debt charge had reached 45,795,000 francs, giving a deficit of 45,000 francs, or, speaking broadly, the total receipts and expenses balanced. By 1883 the surplus was 48,500,000, francs, the debt charge having grown to 52,500,000 francs thus making a deficit of 4,000,000 francs. Higher rates were imposed as a remedy for this evil, and in 1891 the surplus over working expenses reached 58,000,000 francs.

The experience of other European countries in regard to the financial effects of state-owned railways does not materially alter the conclusions that the cases already examined suggest. Holland and Italy (since 1885) have preferred to lease the state lines to private companies. Russia has conformed to the general tendency in favour of railway nationalisation. In January 1887 the state railways were only 4,418 verstes in length as against 21,045 verstes in the hands of companies. In September 1892 the relative lengths were 11,536 and 17,152 verstes. On September 1st, 1901, the state railways comprised 34,998 verstes, only

[1] The zone tariff policy of Hungary has improved the net receipts, but it is perhaps too soon to say whether the improvement will be permanent.

14,913 verstes remaining under private control. The financial results have not been satisfactory : for the fifteen years 1886–1900 the expenses have exceeded receipts in twelve, but a part of the outlay is properly assignable to capital. The excess of receipts over working expenses on the state lines amounted in 1900 to 114,500,000 roubles. Roumania, Norway, Sweden, and Denmark have most of their lines under state ownership, which in the former countries does not give sufficient surplus to pay interest on capital charges. Spain, Portugal, and Switzerland have as yet substantially adhered to the system of private enterprise.[1]

§ 16. Outside of Europe the railways have been mainly an item of state expenditure to the various governments. Both in North and South America large grants of land and guarantees of interest have been given as inducements to the undertakers of railways. Brazil and Chile possess some state lines which do not pay the interest on their capital. The government lines of Canada have not even paid working expenses for any year since 1871, and the accumulated excess of expenditure over receipts since confederation in 1868 amounts to over 7,800,000 dollars, besides the capital expenditure of 58,000,000 dollars.

The Australasian colonies have entrusted the work of railway construction to their governments, who have borrowed largely for the purpose. In the year 1892 the total receipts from the Australasian state railways were £10,040,000 and the working expenses £6,533,000, showing a surplus of over £3,500,000. The debt contracted for railway service, however, amounted to £123,100,000, with an interest charge of over £4,600,000. Thus the railway system, so far from being a source of gain, really involved expenditure to the amount of about £1,100,000. In all the colonies except Victoria the administration has been placed in the hands of an expert commission, with satisfactory

[1] In addition to works already referred to, see Von Scheel in Schönberg, 94–104.

results, especially in New South Wales, where the surplus nearly pays the interest on railway debt.[1] It may reasonably be expected that the growth of population will in future largely increase the railway receipts in all the colonies without proportionally raising the working expenses.[2]

Indian railway policy is financially interesting as affording a further proof of the readiness of English administrators to adopt a system quite different from that of their own country. As in Australia, the State has taken a great part in the extension of railway communications. The first method was that of securing or guaranteeing interest to private companies, under which stimulus some of the main lines were constructed. Then came the pressure of military necessities and of famine relief. A number of smaller and less important lines were established, and for the most part worked by the government. Finally, financial conditions have made it desirable to return to the guarantee system, but at a lower rate of interest and for a limited time. Though the receipts from the state railways are large (195,517,000 rupees for 1893–4), the expenditure is still larger (215,458,000 rupees for the same period), so that if the net balance only be taken into account, there is an annual outlay for the service.

[1] See Mr. Acworth's instructive article, 'Government Railways in a Democratic State.' *Economic Journal*, ii. 629.

[2] *Victorian Year-Book*, 1893, ii. 475–7. The following table gives more accurate figures for each colony :—

Colony.	*Receipts.*	*Working Expenses.*	*Surplus.*	*Debt.*
	£	£	£	£
New South Wales..	3,390,827	2,150,220	1,240,607	37,261,215
New Zealand ...	1,154,592	690,627	463,965	14,478,723
Queensland	1,049,870	632,182	417,688	17,872,458
South Australia ...	1,073,020	688,079	384,941	11,719,038
Tasmania	178,410	161,553	16,857	3,769,643
Victoria...	3,098,251	2,118,377	979,874	36,672,449
Western Australia..	94,258	92,600	1,658	1,359,651
Total	10,039,228	6,533,638	3,505,590	123,133,177

§ 17. The statistics of state-railway finance have been given at some length in order to facilitate the formation of a correct judgment on the system. Within the last thirty years the movement towards 'railway nationalisation' has been increasing in force, and though the grounds on which it has to be decided belong mainly to economic policy in the widest sense, financial considerations cannot be altogether neglected. The one conspicuous financial success of state-managed railways is found in Prussia, of which the minor German States, as Cohn points out,[1] fall very far short. France, Belgium, and Russia in recent years have not profited financially from their state lines. Those of Australasia and Canada afford on the whole no direct addition to the public revenues, a statement which is also true of India.

If the question is to be determined on these definite facts, the conclusion ought, we believe, to be against state property in railways. Many other considerations are, however, to be taken into account. Advocates of state property dwell on the future increase from the growing movements of both persons and goods, and regard construction or purchase as a profitable investment for the future. Transport agencies act powerfully in the promotion of industrial and commercial development,[2] and hence it is argued that even unremunerative lines may so benefit the community as to increase the productiveness of other sources of revenue. Again, unity of management, only to be obtained under the state, would reduce working expenses and leave a larger surplus as net profit. The superiority of state credit is alleged as another reason for believing that its ownership would be financially successful. The English Government could some years ago borrow at $3\frac{1}{4}$ per cent. (and now at less than 3 per cent.), and, buying

[1] 'Die anderen deutschen Staaten sind Preussen (sofern sie nicht vorangegangen) in der Richtung der Staatsbahnpolitik gefolgt, haben freilich nicht ebenso günstige finanzielle Ergebnisse aufzuweisen,' § 439.

[2] This is specially true of undeveloped countries such as Australia and Russia.

up the railway shareholders' interests at their market value, would, it is supposed, secure for itself the difference between the return on railway shares and that on Consols. By an extensive investment of borrowed capital a margin of profit would be obtained for the discharge of other public services. The objections to such a policy are obvious enough. There is no financial reason for investment in railroads that might not be applied to other forms of industry. If the advantages of unified management are important, the dangers of attempting to deal with a varied and complicated business are grave. Railway nationalisation as a financial measure is open to the risks that attend similar proposals for land nationalisation. Without accepting Jevons's view that the supposed gain from purchase through the higher credit of the State is wholly a fallacy,[1] it is certain that it depends on a series of events which are uncertain and incalculable. Depression in trade, appreciation of the standard of value, or new inventions would reduce very much the value of the fixed capital of the railway system. The policy of state acquisition exposes the public finances to all the chances of loss that these possibilities open up. At best the system of state owned and managed railways thus appears to be a speculative employment of financial resources, and, judged in the light of experience, to be of more than doubtful advantage to the Exchequer. The general difficulties of state industrial enterprise are besides very likely to occur

[1] 'If the State manages the railways just with the same degree of skill and success as the companies there would then be no gain or loss; if better, there would be gain accruing, not from good credit, but from good management; if worse, there would be certain loss. Thus, in theory, the use of the public credit proves to be a pure fallacy, and if it were not so there would be no reason why the Treasury should not proceed to invest money in many kinds of industrial enterprises besides railways and telegraphs.' *Methods of Social Reform*, 371. The fact that the chance of loss is usually over-estimated is here neglected. Jevons would be right if the same *income* as formerly were to be secured to shareholders, but the suggestion is that only the *market value* of the shares should be given. It would, however, be very difficult to carry this out in practice. Railway shareholders would claim, and probably receive, compensation for their sacrifice of possible increase in future dividends.

in this case. Defective accounts of capital and revenue expenditure and receipts cannot be escaped any more than in the dockyards or arsenals. With the best intentions it is not easy to distinguish clearly between the different sources and applications of the funds with which a railway administration has to deal; and yet to get a perfectly trustworthy statement of the financial position of state railways is essential for a correct judgment on the policy that has created them.

§ 18. What the railway system is to the nation tramways are to the town, and therefore it is quite in accordance with the general course of policy that there should be an effort to 'municipalise' these means of communication. English legislation places local governments in an exceptionally favourable position, either for establishing tramways themselves, or, after the expiration of a period, purchasing the rights of companies. A large number of British towns own their local lines, but up to July 1st, 1899, only seventeen municipal bodies worked their lines; in other cases the lines are leased to companies. Capital to the amount of £3,200,000 has been applied to this object by about thirty towns. In the United States 'a few municipalities manage their own street-car lines,'[1] but the number is small.

Though classed in accordance with their nature among the industries of transport, the tramways resemble in their economic and financial aspects the other industries discussed in an earlier part of the chapter.

§ 19. The proper administration of the railway system, assuming it to be owned by the State, is a further problem. Shall the lines be leased to a company, as in Holland, or be managed directly by state officials? The former seems the solution that offers the greatest financial advantages. The full value of the line can be obtained and the chance of loss in a great measure avoided. Unfortunately the objects for which state railways are often desired cannot be accomplished in this way. The lessees will doubtless use their

[1] Ely, *Taxation*, 270.

privilege to gain the highest possible returns, and the evils of competition and unequal rates will continue.

State administration is so much desired by the opponents of private companies that, as in Germany, private lines are leased to the State. In this way great outlay of capital is avoided, and as the management of a railway line may be reduced to a system of routine, there at first appears to be a fair analogy with the Post Office. This resemblance is only apparent. Instead of the simple tariff and limited classes with which the Post Office deals, there must be very elaborate grouping and frequent adjustment to new conditions. The management of a great railway is an industrial 'undertaking' of peculiar difficulty, and is almost certain to suffer from the want of capable direction. The financial success of state-managed railways will be affected by the efficiency of the management of so complicated a business, and it is more than doubtful whether the gain through unity of direction and system will compensate for the lack of energy and zeal that state industries display.

A great deal will depend on the particular constitution and situation of the country. The good financial results of the Prussian railroads are largely attributable to the skill and care of the trained officials in the service of that State. Countries where the public service is not so well organised and with governments more subject to popular control cannot hope for equal success. 'I tremble to think,' said Jevons, 'what might be the financial results if a property exceeding the National Debt in nominal value, and requiring in every part of it constant repairs, renewals, and extensions, were in the hands of a Parliamentary minister who might find some day that he had been illegally and ignorantly signing away great sums of money at the bidding of his subordinates.' [1]

[1] *Methods of Social Reform*, 359. His judgment is amply supported by the recent history of the Australasian railways.

The financial working of the system would be particularly exposed to danger; for, in addition to the risk of errors in management, there would be the pressure of public opinion in favour of low fares and rates. If a substantial surplus were realised in any year, it would be impossible to escape reductions that would effectually prevent its recurrence. Victorian experience is instructive on this point. Any increases in the gross receipts of the Colonial lines have been 'absorbed by the additional working expenses' due to extra facilities and lower rates. The Railway Commissioners declare that 'No department controlling state-owned railways can expect to be allowed to realise more than a small margin beyond the amount required to pay the interest upon the capital invested, as immediately that point has been reached the public request and insist upon concessions in rates or increased facilities, both of which are practically an amelioration of taxation.'[1] It remains to be seen whether Prussia will succeed in maintaining her high revenue from railways when once a movement for remission of taxation sets in. Cohn, for example, justifies the railway surplus on the ground that it is derived from the well-to-do classes, and makes the distribution of public burdens fairer, but if the duties on commodities of general use, which are so heavy in Germany, were modified, the claim for lower railway charges could not be met in this way.[2]

The question of compensation for loss is another serious financial point in railway administration. State post offices escape the difficulty by repudiating all responsibility, no matter what loss they inflict, but railways could not follow this most objectionable method. Over a large system it is probable that the cost of accidents and other losses could be averaged from year to year, though some variation would still occur. Smaller countries would not have this refuge from loss. A single heavy accident

[1] *Victorian Year-Book*, 1887–8, ii. 139.

[2] Cohn, §§ 440–1. See also his article, *Economic Journal*, ix. 93 sq., which shows that the claim for lower rates is being made in Prussia.

would disturb the balance, and turn profit into loss. The Victorian railways had for a single accident to pay claims to the amount of £128,988; but the total expenditure under that head for the year in question (1887–8) only amounted to £142,562, while for the preceding year it was but £6,655. It is moreover highly probable that if the amount of compensation were assessed, as at present in England, by juries, their bias would be altogether against the railway administration, and to a greater extent than it is now against private companies.

§ 20. One difficulty common to most forms of state industry arises from the necessity of dealing with large numbers of employees. The tasks of the modern State are sufficiently varied and comprehensive to take up all the ability and time of administrators, without adding unnecessarily to their duties. Public industries, however, require for their efficient working a body of organised hands, obtained by free contract. An unavoidable consequence is the possibility of disagreement between the State and its helpers, culminating perhaps in the last weapon of industrial war—strikes.[1] The position of the public powers is in such cases a trying one. The agency that is bound to enforce order and fair play is one of the parties to the dispute; the natural disposition of an administrator in a popular government is to make things smooth by yielding to the demands of the discontented, a course that involves additional expense and injuriously affects the financial position. The pressure of the consumer—that is the community—for low rates, and that of state officials for better conditions of service, is the most serious financial risk that the industrial activity of the State is likely to encounter. The Prussian railway service controls its 80,000 employees on an almost military system, aided by the organisation of the national army. But any

[1] That this is not an imaginary danger is proved by the fact that in July, 1890, there were 'strikes' at the municipal gasworks in Leeds, at the London Post Office, and in the Metropolitan Police, and also a 'mutiny' in the Guards!

attempt to direct the railway system of the United Kingdom on a similar plan would be hopeless.

§ 21. But whatever be the judgment that we form as to the expediency of the policy, there can be little doubt that it has had important effects on public finance. In most European States a new branch of the public domain has been called into existence, with very large gross receipts. The weight of public indebtedness has moreover been increased, and the real nature and results of that burden have been obscured.[1] A large section of private industry, that would otherwise contribute to the public resources through taxation, has come into the charge of the State. The broader social and political results do not concern us here. But the purely financial consequences of a continuance of the movement have much interest. One inevitable result will be the comparative reduction of tax-revenue as contributing to the gross receipts. The addition of English railway expenditure and receipts to the national Budget would far more than double its already portentous sum.[2]

[1] Bk. v. ch. 5, on the so-called 'reproductive' debt.

[2] The railways of the United Kingdom show the following results for the year 1900 :—

Receipts from all sources ...	£104,801,858
Working expenditure	£64,743,520
Net receipts	£40,058,338
Paid-up capital	£1,176,001,890

The gross public revenue for the year ending March 31st, 1901, was

	£114,774,287
The total expenditure	£167,981,867
The National Debt at the end of the year was...	£705,723,878
The charge of the debt for the same year...	£19,835,488

The inclusion of the railway accounts in the Budget would raise the receipts to nearly £220,000,000, and, assuming the shareholders to receive their present income, the total expenditure to over £270,000,000, and the public debt to about £1,880,000,000. If the now standard 2¾ per cent. stock were to be given, the capital would be proportionately increased, or severe loss inflicted on the shareholders who had invested in the assurance of being undisturbed. The establishment of a sinking fund, in the same proportion as that applied in normal times to the present debt, would necessitate increased taxation, unless state management proved very much more economical.

Under such conditions the ordinary method of interpreting financial returns would prove defective. At present the Post Office unduly affects the balance of the Budget, but its effect is insignificant compared with accounts of the magnitude of the railways. The Indian Budget, as Fawcett very clearly showed,[1] is open to misinterpretation on this ground. Until the gross and net figures are separated and arranged, there are no correct data for discussing the financial situation.

Of more weight is the fact that this great increase of gross receipts and expenditure would leave the real power and burdens of the country almost unchanged. The financial condition might be a little better or a little worse, according as there was a net gain or loss from the new state domain; but in substance the public wants would still have to be met from taxation, and the pressure would fall on private income, since the large revenues from quasi-private possessions would have corresponding charges against them.

The system of creating a state industrial domain by the policy of granting long concessions, with ultimate reversion to the State, is by far the most plausible. It appears to be a form of saving by securing advantages in the distant future at a small present sacrifice. For we cannot believe that the concessionnaries do not endeavour to compensate themselves for their shorter term by increased charges, the result of limitation of advantages. Such is apparently the case in France, where the railway companies, if their tenure is limited, derive a counter advantage from the very high dividends guaranteed to them.

From one point of view the formation of a state property may be regarded as a mode of saving, somewhat analogous to the treasures accumulated by sovereigns in earlier times. A long-continued process of judicious investment might succeed in raising these accumulations to a very large amount, but under modern conditions it is better to trust to

[1] *Indian Finance*, 17–25.

taxation for the needed revenue, and allow the investment of capital to proceed from the action of individuals. It may be further remarked that each extension of state ownership and management is a step in the direction of Socialism. That the growth of public industries, if carried on unchecked, would ultimately transform society into the type desired by the more thoughtful Socialists, is undeniable; and, whatever may be the merits of this kind of social organisation, it is utterly incompatible with the continuance of the conditions which existing financial theories assume. During all changes of social life, the fundamental economic and financial categories will survive, but their form may be so changed as to render entirely new expositions essential. We are not called on to discuss socialistic proposals, but, to all who recognise their impracticability, the encouragement to Socialism that attends the extension of the industrial domain of the State may be noted as a further objection to it.

CHAPTER IV

THE STATE AS CAPITALIST. ADMINISTRATIVE REVENUE

§ 1. THE agricultural and industrial property of the State, though the former has lost most of its importance and the latter is confined to particular sections of industry have both retained a place as substantial sources of revenue in the case of at least some countries. The domain, the forests, and the railways of Prussia contribute a considerable amount to the budget, and cannot be passed over in any estimate of the financial position of that country. The land revenue is a mainstay of Indian finance, and England would feel the loss of the postal revenue. Very different is the position of what once might have been regarded as a co-ordinate part of the quasi-private income of the State, viz., the revenue from commerce. At one time the regulation, and even the monopoly, of certain branches of trade was believed to be a part of the royal prerogative. This position, which was most strongly held in the sixteenth century, gave way before the presence of new economic forces and the criticisms of the more intelligent theorists. It is now universally recognised that, to use Adam Smith's words, 'no two characters seem more inconsistent than those of trader and sovereign.'[1] The speculative nature of commerce, the need for constant watchfulness and minute calculation of the chances of gain or loss which

[1] *Wealth of Nations*, 344

are its essential features, make it impossible for a State to hope for revenue by engaging in it.

Exceptions to this general rule are rather apparent than real. When a State possesses and works lands, forests, mines, or factories—unless the products are used in the state service—it must find a market for what it turns out, but even this irreducible minimum of commercial transactions is the weakest part of state economy, and by its risks forms an additional objection to those already urged against increasing public lands or industries. The same necessity, of course, exists where an article is artificially monopolised for the purpose of effective taxation, a process that is sometimes confined to the sale, leaving the production to private enterprise. Revenue obtained in this way is virtually taxation on the commodities so treated, and must be considered in that connexion. The only special case that we need notice is that of the Dutch Government trade from Java. Under the 'culture system' large quantities of valuable products, chiefly coffee, tea, and spices, were received by the Colonial Government and sold at a high rate. For many years large surpluses were realised, but lately the modifications of the culture system and the fall in prices have led to deficits in the colonial budget, and given still further proof of the hazardous nature of such revenues.[1]

§ 2. The business of banking is in so many ways connected with the State that its public management appears to have much to recommend it. The ordinary method has, however, been that of granting concessions to privileged companies, which are bound to afford facilities to the State in return for advantages enjoyed. England, France, and Germany at present adopt this policy, with the various modifications that the circumstances of each country make advisable. The pure 'state-bank,' in which the capital of the undertaking is supplied from the public funds, is

[1] The Dutch policy in Java is too favourably described by A. R. Wallace, *Archipelago*, chs. 7 and 17. See also Wagner, i. 626–7.

found only in Russia and Sweden. In most countries banks contribute to the revenue either by the special services that they perform for the State, by taxation, or by sharing profits over a certain point with the Treasury, the last being the system of the German Imperial Bank.[1]

Banking may naturally be divided into dealings (1) with money, and (2) with capital. There are strong reasons for regarding the former as a state function, and it is probably from this part of the business that public revenue may best be obtained.[2] The trade in capital, on the other hand, seems entirely unfit for governmental intervention, though some small revenue may be gained from it by judicious taxation.

The relations of public finance with the banking system are not confined to questions of revenue. The public debt in its different forms, especially that of inconvertible paper issues, is mixed up with the trade in capital, and the whole mechanism of the financial system is dependent for its successful operation on the agencies of credit. We shall therefore have more than once to return to the subject.[3]

Another form of state banking has come into existence in the last thirty years in the savings bank, which originated in England in 1861, and has extended to Belgium, Italy, Holland, France, Austria, and Sweden; but its financial importance is confined to the aid which the large deposits afford in the creation of terminable annuities.

§ 3. A more important but at the same time more questionable source of revenue is by many States derived from the receipts of lotteries conducted by the government. The tendency of the State to seek gain from the errors or vices of its subjects is very noticeable in the earlier periods

[1] The Imperial Bank of Germany appears as an annual contributor to the Budget, the amount for 1901 being 12,417,770 marks.

[2] Cp. Ricardo's 'Plan for the Establishment of a National Bank,' where the two branches of banking are carefully distinguished. *Works*, 503–12.

[3] For inconvertible issues as a form of loan see Bk. v. ch. 6, and for the relation of the Treasury to banks see Bk. vi. ch. 2.

of financial history. Appeals were often made to men's 'absurd presumption in their own good fortune,' by the establishment of periodical lotteries, in which the contributors, taken as a body, were certain to lose. In many cases the lottery became a state monopoly, and several examples still exist. The Prussian budget estimate for 1902–3 assumes a yield of 88,263,500 marks from this source. Italy is the receiver of a large revenue from lotteries, the gross yield for 1901–2 being computed at 67,500,000 lire. Saxony, Hamburg, Spain, and Hungary are also indebted to this system for a portion of their revenues. The objections are rather moral than economic, though the virtues weakened by the prevalence of gambling are the peculiarly economic ones of prudence and willingness to acquire wealth by labour.

From the purely financial point of view, the more refined lottery systems depending on combinations of numbers are objectionable, as there is some uncertainty as to their gains. The State is exactly in the position of the banker of the gambling table. Thus 1885 was a bad year for the Italian lottery, 1886 a good one. The simple method of prizes arranged in classes is preferable, but it appeals less powerfully to the spirit of adventure, on the prevalence of which the institution depends for its continuance.

The pernicious effects of state sanction of the vice of gambling have led to the abandonment of the lottery system in England (1826), Hesse (1832), France (1836), Sweden (1840), Bavaria (1861), and Switzerland (1865).

§ 4. Adam Smith has made the institution of a 'public pawnshop' familar by his reference to the case of Hamburg ; and many similar establishments in the shape of the '*Monts de Piété*' in France, Belgium, and some German States are in existence. The proceeds, when they exceed the advances and cost of working, are not applied to public use, so that the whole system is rather a charge, chiefly on municipal revenues.

A priori it would seem that the lending of accumulated

wealth would be a convenient mode of securing a revenue for the public services, but, as in the case of industrial investments, the test of experience makes it plain that this is really an expensive way of obtaining the necessary supplies, since the principal has first to be raised, and is afterwards less productively employed than when left in the ownership of private persons. A true conception of the relation of state income to the national income, which is the sum of all private incomes within the nation, overthrows the fallacy of state accumulation and investment.

Notwithstanding the force of this general canon, the financial accounts of modern States exhibit apparently many examples of advances of capital by the State, but on closer investigation these cases turn out to be connected with the use of public credit. For the furtherance of certain economic or social ends, such as the improvement of land, or the erection of better dwellings for workmen, or municipal improvements, advances are made by the central government either to individuals or to local bodies, but these loans are themselves ultimately derived from private capital by means of public credit. The Treasury acts simply as an intermediary in supplying capital for certain desirable objects—a position made clear in England by Viscount Goschen's separation of the local from the general debt. Repayment of the money so advanced is but the appropriate method of discharging the amount of debt that was contracted for the original loans.

§ 5. The interest on capital lent out is thus not a source of state revenue that need receive attention here, since it does not really increase the public receipts. We may therefore pass on to consider those kinds of revenue that are fixed in amount and admit of capitalisation, a circumstance that connects them with the gains from invested capital, notwithstanding that their origin is very different.

Foremost amongst such revenue is the gain from charges,

on land. In an earlier chapter of the present book we found that the agricultural domain had often passed gradually from the hands of the sovereign by the introduction of hereditary leases. Permanency of tenure without limitation of rent is of little benefit, as increase in the charge can always be imposed in order to destroy the tenant's interest. Consequently the fixing for ever, or for a long term, of the rent to be paid accompanies the hereditary lease. The variable payments become settled and definite charges.

In another way the same form of revenue comes into existence. The servile tenures of the Middle Ages prescribed a great variety of duties to be performed by the tenants, which under the new conditions of 'money economy' were commuted into fixed sums. English legislation on copyholds, the measures of the French Constituent Assembly, and Prussian land legislation since 1807 have all had this commutation and settling of dues as one of their objects. The tithes—so peculiarly distinctive of ecclesiastical property—have also undergone the same treatment, wherever they have not been abolished. The universality of the forces that work this change is shown by the extension of the terms of the Indian land settlements and the favour in which perpetual settlements are held. The difficulties as to drawing a distinction between rent and taxation in India have been already noticed, as also the fact that with a perpetual settlement the state receipts in reality belong to neither head, but are a thing *per se*.[1]

A still further question arises, viz. whether long-continued taxes on land should not be included in this class of receipts. Much controversy has arisen in connexion with the French *Impôt Foncier;* one party contending that its burden has ceased to be felt, since all purchasers deducted the capitalised amount of the tax from the purchase money, while opponents of this view have brought forward the ever-open possibility of changes in the amount so levied. The

[1] See Bk. ii. ch. 2, § 2.

broader theoretical aspects of the matters at issue will occupy us in studying taxation,[1] when we shall see reason for adopting the last-mentioned view, but some concession can be made to the advocates of the rent-charge conception of land taxes. Where, as in the case of the English Land Tax of 1692 (originally intended to include all property, but evaded by the holders of movable wealth), the amount is fixed on each estate, it does become a charge on the land. The system of redemption, applied first in 1798, is of itself sufficient to prove the correctness of this view. The so-called 'English Land Tax' is gradually disappearing. From its highest point of £1,911,663 in 1798, it has come down to £755,000 in 1900–1.[2]

The expediency of allowing redemption by the parties liable to such charges depends altogether on the nature of the burden. So long as the land tax was, or was intended to be, variable, permission to capitalise the payments would necessarily be futile, since a fresh charge could always be imposed, but, where fixity has been introduced, redemption is generally for the advantage of both sides: for that of the person liable, since otherwise he would not consent to redeem, and for that of the State, which is thereby enabled to reduce its liabilities. Whether a charge should be fixed or not depends on the way in which it has been established, and is mainly determined by considerations of public policy. The conversion of taxes into fixed payments is, however, unquestionably an error in finance, as owing to the growth of public expenditure, provision has to be made for procuring larger sums, while the immobility of each existing tax compels the financier to have recourse to new and, on the whole, less eligible sources of revenue. The same consideration applies to commutations of rent, either of land, of mines, or of concessions for rail-

[1] See Bk. iv. ch. i. § 9.

[2] See Dowell, *History of Taxation*, ii. 48 sq., and iii. 81–91, for the history of the tax. Movable property was exempted in 1833, and offices and pensions in 1875.

ways, canals, and other undertakings. The probability is that they will give a larger return at each renewal, and this additional gain is lost by commutation for a fixed sum, unless, indeed, full allowance is made in the arrangement for the value of the increments that may reasonably be expected in the future. Such transactions are not usually settled on terms favourable to the public interest. An individual will not estimate a very distant gain at its real value to the community, and, as a result, the fixed payment will be but slightly raised by the inclusion of a benefit to be obtained later on. Financially, it is best to reserve these prospective receipts for the new objects of outlay that are certain to arise.

§ 6. Besides the services attached to land, there is a miscellaneous group of receipts which may conveniently be noticed here. Historically they belong to the class of *regalia*, and are due to the sovereign's prerogative. Amongst them we may mention charges for the privilege of hunting, or of fishing, which to some small extent contribute to the public revenue at present. Mediæval finance expanded this class of receipts to a remarkable extent. They acted, as Roscher as shown, as a traditional form between the earliest condition, in which the domanial revenue sufficed for the royal service, and the later state economy depending chiefly on taxation.[1] Our modern customs and excises appear in germ in these feudal or imperial dues. Succession duties can also be referred to the same source; but, apart from what may fairly be regarded as tax revenue in rudimentary form, there are the well-known feudal aids, the right of the sovereign to fines, that of taking ownerless goods, and the numberless other claims that the ingenuity of lawyers succeeded in establishing.

Modern finance has chiefly to deal with these prerogative rights so far as they help to explain the evolution of existing systems of taxation, or in the scattered remnants

[1] Roscher, § 18. The whole chapter (Bk. i. ch. 4) is one of the best in his work.

which are found as survivals in every country, inexplicable except on historical grounds. The discussion also serves as a suitable introduction to another class of public receipts that has presented much difficulty in regard to its correct position in the financial system.

§ 7. The problem of classifying the revenues known as 'fees' (*Gebühren*) need not be again considered.[1] In accordance with the conclusion before reached, no separate department for fees is requisite. Some of the so-called *Gebühren*, *e.g.* the postal revenue, have been noticed in the preceding chapter, others will find their place in the study of taxation, while the remainder of the heterogeneous class will be considered here as a sequel to the fixed charges imposed by the State. By this method the complications that otherwise occur are avoided, and the creation of a distinct group of state receipts, co-ordinate with that derived from taxation, becomes unnecessary.

If further justification were needed for this breaking up of the topic of *Gebühren* that German financial science has laboured so strenuously to develop, it would be found in the remarkable divergences of opinion among its exponents. No two of the able and erudite workers at the subject give precisely the same interpretation and arrangement. The one fixed and definite result obtained can be and is recognised in our treatment, viz. that the 'fee' is paid in return for service done, and that it does not bring in a clear return to the State over and above the cost of the service for which it is paid.

The classification and division of the different kinds of fees is almost as unsettled as the nature and position of the whole system, but when we deduct those charges that really belong to the industrial domain, as also whatever is in fact tax revenue, the difficulty is very much lessened. Special reasons apart, the State may charge for any service rendered to a determinate individual, and therefore it would

[1] See Bk. ii. ch. 1, §§ 4, 5, and note at end.

seem abstractly possible that each public function would have its corresponding fees. State services cannot, as we know, be analysed and their effect on each citizen assigned. The general interests of the society are a matter of importance to all; were it otherwise the whole organisation of the State might be dissolved, and its duties given up to individual enterprise. Fees come in only as a supplement to the other receipts of the public exchequer, and have to be confined to certain cases of measurable services, where the citizen is brought into direct contact with the public power.

§ 8. The administration of justice has been the occasion for the earliest of these charges. Without returning to the previously considered position of primitive law courts,[1] we need only bear in mind that the cost of law services has been more and more placed on the general revenue. From being self-supporting, the cost of justice has been steadily increasing. Nevertheless, a large number of charges are still levied in connexion with legal proceedings in every modern country. The United Kingdom shows net receipts for the year 1893–4 to the amount of £870,844 under the general head of 'Fees,' of which by far the largest part was obtained from court charges. Local governments also receive fees for police and justice which ought in strictness to be added, but the total amount was less than £500,000 for 1887–8. In France the system of court fees in the older form of *épices* was abolished at the Revolution, but the charges for documents and legal forms are still a part of the revenue under the title *Greffe*. The *timbre*, or stamp duty, also affects judicial acts, but the greater part of its return is really taxation. For the year 1888 the receipts from the *Greffe* were 8,225,000 francs. The same category of receipts in Italy for the year 1881 came to 7,000,000 lire. The several German States, as well as the Imperial Government, obtain more or less revenue from the same

[1] Bk. i. ch. 3, § 1.

source. So do many of the American commonwealths, but the value of the comparative figures is very little, owing to the intermixture of fees with taxation.[1]

Besides the revenue derived from contentious proceedings, or from fines on criminals, there are numerous juridical acts which require for their validity the payment of a contribution to the State, or which involve work on the part of the public officials, that can be charged for on the ordinary principle of service done. Such are entries in official registers, grants of naturalisation, and the supply of copies of legal transactions. One of the most important in practice is the dealing with land titles. In all countries with a proper land system owners' titles are registered and changes in the rights over land are recorded. The benefit of such a system to owners and intending purchasers is beyond question, while the cost is very moderate. A low scale of fees for the operations of the registry suffices to cover its expenses, and therefore is an eminently suitable mode of providing for them. Such charges are in principle clearly distinct from the heavy duties on the transfer of land that still exist in France and form a part of the system of *enregistrement*. Low fees have the double advantage of securing without difficulty a good proportion of the expense that administration entails, and of allowing transactions to be carried on without check.

§ 9. Fees for justice and juridical acts shade off almost insensibly into 'administrative fees' (*Verwaltungsgebühren*), so that many of those enumerated in the preceding section might fairly be placed under the latter head, but where the payment is made in connexion with questions of legal right, it seems better to regard it as a 'law fee.' Among administrative fees those for ordinary certificates, *e.g.* of births, deaths, and marriages, may be included the issue of

[1] 'Die absolute und relative Höhe des Gebührenertrages in verschiedenen Staaten mit einander zu vergleichen, ist darum bis jetzt nur höchst unvollkommen möglich, weil die Gebühren fast überall, jedoch mit sehr verschiedenem Grade, mit Verkehrssteuern verquickt sind.' Roscher, § 23, n. 16. Cp. Wagner, ii. 69.

passports, attestation of degrees and diplomas, and the many other payments for special official relations. More important, however, are charges connected with economic transactions, such as fees for testing the quality of articles, that now exist chiefly as survivals of the older system of regulation, as *e.g.* the English hall-mark on gold and silver, or have been introduced on social grounds, as in the case of testing for adulteration.

In this somewhat miscellaneous collection, whose indefiniteness results from the wide extension of state functions, may be placed the revenue from seignorage. The function of coining money is undertaken by every civilised government, and in most cases a small amount of the metal sent for coinage is retained in order to meet the expenses of the process. Where the deduction is limited to the amount necessary to cover the cost it is substantially a fee for guaranteeing the fineness and weight of the currency. The English mint does not even do this in respect to the gold coinage, which is a cause of expense to the State. It is more than recompensed on the token coinage of silver and copper, which gives a varying surplus, amounting for the year 1889–90 to the unusually large sum of £774,000. Receipts of so considerable an amount, if normal, would not be treated under the present head. If it could be shown that the seignorage charge pressed on any class or classes, it would be a special tax levied on them; if it was the result of state monopoly, it would be a gain of the State from the industrial undertaking of coinage. As any large gain is very rare—the receipts of the English mint for 1889–90 were described by Viscount Goschen as a 'windfall which cannot be expected to recur'[1]—and as some mints do not cover their working expenses, it is best to regard seignorage as being one of the class of 'fees.'

Charges for testing weights and measures make another item in the list; so do lighthouse dues and dock charges In almost every case of administrative action there will be

[1] *Budget Speech*, April 17th, 1890. The receipt for 1897-8 was £421,000.

some receipts owing to the definite services that are rendered to individuals or the commodities supplied to them. The sale of official publications may be given as an example.

A comparatively important but diminishing head of revenue from 'fees' is found in school attendance payments. The promotion of education is now regarded as a public duty, involving extensive outlay, which must be supplied either from taxation or from the fees paid by those who avail themselves of instruction. There seems to be no reason why a part of the expenses of the system should not be borne by the parents, unless in the case of actual destitution. The tendency, however, is towards their removal. The United States, and France since 1881, have no fees for primary schools. Prussia still retains them, but they have disappeared in the United Kingdom under the operation of the Education Acts of 1891 and 1892.[1] The higher educational institutions also produce fees in small amounts, as *e.g.* in England the University of London, before the recent change in its constitution almost covered its annual working expenditure by the fees of candidates for its degrees and certificates.

§ 10. Looking back on the list of receipts that may fairly be classed as fees, we see the absence of any harmonious or logical arrangement. There is no branch of the public power to which they can be attributed; they are spread

[1] The amounts paid in 1889 were as follows :—

		£
England.	Fees in School Board schools	635,255
	Fees in other schools receiving grants	1,207,695
Scotland.	Fees in public schools	249,155
	In other schools...	46,164
Ireland.	School fees in National schools ...	110,592
	Total	£2,248,861

In Prussia the school fees were in 1871 10,498,794 marks.
" " 1878 12,975,527 "
" " 1886 10,926,085 "
Cohn, § 190, n*.

over the local and general budgets, and sometimes never come into account, being the perquisites of the officials who receive them, as is not uncommon in the United States. Much of the law that regulates them is only of interest in administration; they are often inextricably mixed up with the public industrial receipts and with taxes, especially 'taxes on commerce' (*Verkehrssteuern*),[1] and finally the aid they give to the financier is not considerable. They may indeed be regarded as incidental products of state action. Just as in manufacturing processes certain by-products are found which are sold for what they can bring or as the labourer disposes of his spare hours for any wages that will overcome his desire for leisure, so the mechanism of the State, while aiming at the efficient discharge of the tasks set to it, nevertheless does not refuse to collect revenue that can be acquired without neglect of the primary object in view, and such revenue is that from fees.

There is thus complete justification for regarding them as an appendage to the quasi-private economic receipts, as we have done in the present chapter.[2]

[1] Cp. 'Bei dem engen Zusammenhang von Rechts- und Verwaltungsgebühren mit Verkehrssteuern in der Praxis und bei der für beide vielfach gemeinsamen Erhebungsform im Stempel ist die bezügliche Einnahme daraus ebenso wie die Gesetzgebung darüber nicht wohl zu trennen. Die Gesetze betreffen meist beide Abgabearten in bunter Vermengung.' Wagner, ii. 69.

[2] See note to Bk. ii. ch. 1 for further discussion of this point.

CHAPTER V

STATE PROPERTY.—GENERAL CONSIDERATIONS ON QUASI-PRIVATE REVENUE

§ 1. We have now examined the different classes of public receipts that can be fairly classed as 'quasi-private' or 'economic'; what the practical financier would describe as 'non-tax revenue.' The component elements are somewhat heterogeneous, a necessary result of the variety and complexity of public administration. Some of the categories shade off indefinitely into the other great class of contributions obtained through taxation, and thus deprive the technical groupings made for practical purposes of the logical consistency needed in scientific inquiry. In another respect the nature of things presents difficulties in the way of precise classification. The 'economic' revenue of the State is the product of property held, or payment for services done, by it. Great masses of public property are, however, not productive of revenue in the ordinary sense. From the Houses of Parliament down to the smallest court-house—from Epping Forest to the village green—there are buildings and lands that bring in no return to be entered in any budget, local or general. They are, nevertheless, a constituent part of the public domain, the loss of which would be seriously felt even financially. They contribute not wealth in the strict sense, but utility, and the problem of determining their financial advantage is therefore a difficult one. It seems that the best mode of framing

an approximately correct estimate is to take the sacrifice that their loss would impose. The destruction of the public buildings of this class in the United Kingdom would place a considerable charge on both national and local resources, and this sum gauges the value of the existing buildings. The same test applies to the land devoted to general use such as parks, commons, and roads when free from tolls.[1] The last-mentioned case shows how revenue-yielding property can pass into the class under discussion, and the French canals previously noticed afford another instance Strictly speaking, the policy of charging fees only equivalent to, or even under, the cost of maintenance is an intermediate stage between using state possessions as a source of economic revenue and abandoning them to gratuitous use.

The extension of this 'unproductive' public domain is one of the remarkable features of the present century. The movement, usually described under the title of 'State Socialism,' has made public authorities owners of museums, picture-galleries, libraries, baths, gardens, and the other appliances of a civilised society. No materials are at present available for forming an adequate conception of the extent of the movement, but of its reality and importance there can be no question. It is not limited to any particular country, and it is as prominent in local as in central government. Though commonly placed under the head of 'State Socialism,' it is really 'communistic' rather than 'socialistic,' since it implies the gratuitous supply of certain advantages that may be wholly unearned by the receivers. The

[1] Other but less satisfactory measures have been sometimes suggested. Instead of the cost of restoration the original cost of production or acquisition would, it is said, show the amount of public advantage obtained from the outlay. This method is certainly easier and more definite, but it overlooks the fact that mere cost, as such, does not determine value, and that all fixed forms of wealth change their values, generally in a downward direction, in the course of time. Land is the only part of the national possessions that is likely in the long run to increase in value. The measure of present exchange value is also inapplicable, as much of the property forming the public domain is not of a kind that is demanded by private purchasers.

classes that benefit directly are not those who contribute, even in labour, to the work of society. The public domain, applied to either state or general use, also influences the financial position by the outlay that is needed to keep it in efficient working. The existence of numerous public buildings, of large areas of land devoted to the service of the community, of works directly supplying state needs, might give a very considerable sum of assets to be entered in the national ledger if an inventory of state property were taken.[1] It must, however, be remembered that the State is in mercantile phraseology 'a going concern.' Its property cannot be realised without suspending the processes of political life, and so long as these continue further expenditure is unavoidable. This part of public property resembles the mansion, demesne, carriages, plate, and furniture of a rich man, which are only productive of wealth on the breaking-up of his establishment, and otherwise involve him in additional outlay.[2] Each is, in the language of modern economists, the 'consumers' capital' of the proprietor, affording utility but not revenue in the narrower sense of the word.

These various points of connexion are quite sufficient ground for noticing the unproductive possessions of the State, and their suitable position is plainly in immediate sequence to that other section of public property which does contribute to the resources of the budget. Between land earning profit and land that merely affords enjoyment there are so many intermediate gradations that we pass almost insensibly from one to the other; and the same statement is applicable to some other forms of fixed capital.

There is an evident convenience in the use of separate terms for these two classes of public property. The

[1] As pursued in Italy under the system of M. Cerboni.

[2] As pointed out by Mr. Devas—*Pol. Economy*, 585—there may be a financial gain by the inducement given to foreigners to settle in the country, *e.g.* Italy with its artistic treasures. Further, the earning powers of the inhabitants may be increased. This property is then indirectly productive.

language of French administration describes the revenue-giving part as '*Domaine privé de l'état*,' while the remainder is the '*Domaine public*,' though the latter term is sometimes used in a wider sense to include all the possessions of the State. The phrase '*Domaine privé*' has often a legal rather than an economical or financial meaning, and denotes the property held by the State as a juristic person. Stein has proposed the terms '*Domänen*' and '*Staatsbesitz*' for the 'productive' and 'unproductive' parts of the public property, and perhaps the best English equivalents would be 'domain' and 'property,' though the latter is rather too vague unless qualified by some limiting term.[1]

§ 2. All the sources of revenue described in the present book possess one common feature that differentiates them from the tax receipts. Their amount has no essential connexion with the public wants. No matter what may be the demands on the public treasury, the various parts of the national domain will continue to give the returns that the economic conditions establish. State lands will afford rent, state investments interest, and state industries profit under the normal form of those divisions of income. They will not increase in times of pressure, nor will they diminish when funds are abundant, and they therefore deserve the epithet 'mechanical' as opposed to 'organic' which has been given to them.[2] This feature of itself makes recourse to taxation a necessity in times of increasing expenditure. Even on the supposition that England had sufficient returns from its economic revenues to meet the expenditure of 1790, the French wars would have disturbed the balance, and it would never since have been restored. It might appear that the proposition just stated is not strictly exact. Fresh state wants might lead to more judicious management of the domain. Rents might be brought nearer to the economic limit. State industries might be

[1] Leroy-Beaulieu, i. 28; Say, *Dictionnaire d'Économie politique*, i. 719; ib., *Dictionnaire des Finances*, i. 1482–85; Stein, ii. 144 sq.

[2] Umpfenbach, 78.

worked with a closer eye to profit, and fees, notably, might be made higher. This qualification is only apparent. The previous low receipts were either the result of bad management or of a particular line of policy, and if the former, could have been rectified apart from the new needs, if the latter, would involve the loss of the object previously aimed at. Increased rents may retard agricultural advance, higher railway charges injuriously affect commerce, and increased fees tend to limit the transactions on which they are charged. Assuming then that pre-existing receipts have been arranged on correct principles, no increase can be obtained without a corresponding loss to the community, and in many instances it will be really taxation, as may easily happen with regard to any economic source of income. It is further probable that new demands will act injuriously on the economic revenues, *e.g.* war with its accompanying expenditure retards social progress.

The antithesis between 'mechanical' and 'organic' revenue is thus shown to be based on the natural conditions of the two classes, and to indicate the place of each in a developed financial system.

§ 3. The division of the mechanical sources between central and local authorities is in general determined by the history and situation of each particular country. Land may, it would seem, be held either by the State as representing the sovereign of mediæval times, or by the parish or *commune*, which is the descendant of the old village community, but peculiarities in legal development have influenced the actual position. The English parish is very different from the French *commune* with its juristic personality and separate property.[1] The *commune* and the State are in most European countries the only public powers that have had enough continuity of existence to acquire the ownership of land. The Crown and Church possessions

[1] The Local Government Act (1894) by the creation of parish councils and the powers given to the parish as a unit has considerably diminished the force of this contrast.

have passed to the latter, the 'waste' of the district to the former.

Intermediate bodies under unified governments, *e.g.* the English 'County' and the French 'Department,' have little economic receipts, and what they possess is of recent origin. Federation naturally supplies the principal subdivisions with larger possessions, or rather it leaves them the wealth which they held before union, though in certain cases the tendency is towards placing land, and especially forests, under the central government.[1]

With regard to industrial undertakings the general rule, confirmed by practice, is in favour of placing them in charge of the State. Local bodies cannot be expected to deal wisely with the complicated and involved questions that must arise. The principle of 'particular interest' is the reason for a class of exceptions. Just as those public functions that principally concern a town or district should, generally speaking, be entrusted to its authorities, so should the industries connected with those functions or services. It is on this ground that municipal gas and waterworks, main drainage systems, and tramways are to be justified. Such undertakings are most prominent in urban districts, but, if needed, rural bodies may fitly carry them out. Local railway lines (*e.g.* the *Chemins de Fer d'intérêt local* of French finance) may be, and sometimes are, owned by the appropriate local body. The railways possessed by the various German States would probably be more successful if they were in the hands of the imperial administration, and such was the original design of the promoters of state purchase, only defeated by the jealousy of the smaller States.

Postal and telegraphic administration and industries monopolised for the purpose of special taxation are best suited for administration by the general government. As

[1] Cp. the recent Swiss legislation on forests already mentioned (Bk. ii. ch. 2, § 10), and the surrender of public lands by American States to the Federal Government.

regards the various receipts capable of capitalisation no general rule obtains. When they are received by local bodies supervision by state officials is desirable in order to prevent maladministration or redemption for insufficient value, but there seems to be no reason for depriving a town or district of any resources of the kind that it may possess. Its taxation is so far reduced, and the nation as a whole has no claim to the funds.

Fees have to be distributed according to their source. Local administration is fairly entitled to what may be called its 'incidental earnings.' On the other hand, all administrative revenue that is gained by agents of the central government is justly due to it. By this simple rule much confusion is avoided, and there is the best chance of effective control.

A like consideration ought to guide the division of un productive property. Whatever land or buildings subserve the wants of local administration should belong to the authority so administering ; the general government should retain the remainder. Thus buildings for the local courts parks, or baths for a town are best put under local control National museums or libraries, or the principal courts of justice, belong rightly to the State.

§ 4. The necessity or advantage of general rules on the subject of division is, however, much reduced by two circumstances viz. first, the variety of conditions in different countries, and the numerous modifications in the structure of local government. Much more depends on the character of the particular people, or even the particular body, than is usually the case in finance. Thus the devolution with benefit of powers to the Corporation or to the County Council of London is no argument for a similar course with the municipality of Paris. Nor can inferences be safely drawn from both these bodies to the proper position of the Corporation of New York. At present the duty of the inquirer is rather to note the actual phenomena, avoiding hasty generalisation. The other qualifying circumstance

is the interaction of the central and local bodies in respect to finance. Not to touch as yet on taxation, we can, even at present, see that land belonging to the *communes* may for financial reasons be managed by the State, and the receipts paid over to the owners. Again, local bodies may for convenience or economy take charge of public property which is essentially that of the State. So also general fees may be received by local officials, or *vice versa*. The consequence is that the two agencies, or rather the two sides, of the public power are so interlocked that systematic distribution of revenue cannot be made without a comprehensive survey of the whole position, and full allowance for the many influencing conditions.

§ 5. A final question now presents itself, viz. what is the proportion of revenue contributed by the 'mechanical' sources? Or, in other words, how much is left to be supplied by taxation? The answer, it need not be said, will vary according to the time and the country to which it applies. In some German States, at the end of the Middle Ages, taxation did not exist save as an exceptional resource. The present English or French revenue is almost wholly made up from this 'extraordinary' aid, as it was anciently called. And many intermediate positions are to be found.

Before entering on these particulars we must recall a distinction noticed already for another purpose, viz. that between gross and net revenue. Modern finance has accepted as correct the policy of bringing all sums received and expended into account, so that the budget shall reveal any defect in the operations carried on. For scientific analysis it is just as necessary to eliminate certain elements from each side of the accounts. To take the nearest example. In the English accounts for the year 1900–1, Posts and Telegraphs figure on the revenue side for £17,250,000, and form over 13 per cent. of the receipts. The expenditure was, however, taken as £12,700,000, and this, deducted from the former sum, leaves the more

modest item of £3,550,000, or less than 3 per cent. If all the component parts of revenue were equally affected by this diminution there would be no difficulty in comparing amounts; but the nature of the quasi-private State revenue makes the gross largely exceed the net receipts, while in respect to taxation the existence of any remarkable difference between the two is of itself a strong objection to the particular form so affected as showing undue cost in collection. Nor are these differences confined to the tax as opposed to the non-tax receipts; within the latter class the relation of net and gross revenue is not in every, perhaps hardly in any, case exactly the same. The Indian land revenue gives a very high proportion of net return. In 1899–1900, about £14,500,000 out of £17,200,000. The Prussian mines, on the contrary, give very little net receipts, and some purely industrial enterprises have often a balance on the wrong side.

What is most important at present is to recognise that in estimating the financial merits of the various sources net revenue is the only sound basis of calculation. No matter what are the gross incomings, if there are equal outgoings the exchequer does not benefit. Taking this view, we are led to reduce very much the importance of the economic receipts. Except in the case of rent the net returns are small. Even the Prussian state railways, the most profitable of public undertakings, do not produce much revenue when compared with the total net receipts of the budget. Besides, the intrusion of the tax element tends to deprive some of the most important public industries of their purely economic character.

§ 6. The intermixture of economic and tax revenues as well as the complications of net and gross receipts, and the involved relations of capital and revenue accounts, prevent a precise and definite answer regarding the proportion of public expenditure defrayed out of taxation. It is, however, possible to give approximate results that are not without value. In the English financial year

1901–2, the receipts from taxation were £121,893,000. The cost of collection was £2,970,000, leaving a net return of £118,923,000. Non-tax receipts came to £21,105,000, expenditure to £13,300,000, and the net receipts to £7,805,000.

Passing over the various readjustments that the question of fees and the distribution of interest on capital charges might in strictness necessitate, 94 per cent. is obtained from taxation against 6 per cent. from other sources. Local finance in England and Wales for the year 1898–9 (the last available) gained by taxation £38,600,000 directly, and £11,790,000, from contributions of the central government. Gas, electric lighting, waterworks, and tramways yielded over £10,430,000, while their cost was £7,785,000. This balance of £2,645,000 has to be further reduced by the interest on debt incurred on the industries in question, or about £2,350,000, the net gain being brought down to less than £300,000. Tolls, dues, repayments, rents, and dividends came to about £9,000,000, from which the uncertain cost of collection has to be taken. The broad inference from these figures is that about two-thirds of the gross local receipts come from taxation, the remaining one-third being otherwise obtained, but that in the net receipts taxation stands to other sources in the ratio of 5 to 1.[1]

Germany shows a somewhat different position. Nearly all the German States have a good percentage of their gross receipts from economic revenue, but when the cost of gaining that revenue is taken into account there is very little surplus left. Thus the estimated net revenue for the year 1902 from the Prussian lands and forests (other than railways) is 59,600,000 marks (£2,980,000); that from mines and salt-works 30,800,000 marks (£1,540,000), the railway earnings (part of which is taxation) contributed 532 million

[1] The returns of local finance for Scotland and Ireland fail to distinguish between tax receipts and payments for gas and water. Nor are the English accounts as yet quite clearly separated. For earlier periods they are almost useless for the present purpose.

marks (£26,600,000), or a total of about 623 million marks (or £31,150,000).[1] The gross receipts would convey a quite different impression. They for the same year are estimated at 1,714 million marks, the corresponding outlay, net working interest on railway debt, being 1,091 million marks. As the gross receipts from all sources are taken at 2,614 million marks, while the net receipts only reach 883 million marks,[2] we may conclude that though the domain and industrial undertakings were over 62 per cent. of the gross, they formed a smaller proportion of the net income.[3] The inclusion of fees and administrative revenue would increase the proportion of economic receipts, but the tax element is so prominent in them (especially the law fees) that the correctness of this course is doubtful.[4]

The other German States resemble Prussia, though in their case the proportion of net receipts by taxation is probably larger, as their net income from railways and mines is lower. Austria and Hungary, too, gain much less than Prussia from the economic sources of revenue.

India is the only other country whose proportion of economic revenue is deserving of attention. One noteworthy feature of Indian finance is the contrast between its most productive sources and those of European countries, especially Great Britain. Its financial mainstay

[1] The interest on the railway debt has also to be taken into account.

[2] This even includes the interest on the state railway debt, which should in strict accuracy be deducted.

[3] The contributions (*Matricular-beiträge*) of the States to the Empire and the assignments from the imperial revenue to the States further confuse the statistics. In 1889-90 the Prussian contribution was 114,000,000 marks, the assignment from the imperial revenue 170,000,000 marks, showing a net gain to the Prussian revenue of 56,000,000 marks (£2,800,000). For 1894-5 the contributions are estimated at 234,000,000 marks, the assignments at over 215,000,000 marks, or a net loss to Prussia of 18,700,000 marks. In 1902-3 the Prussian contribution is estimated at 347,912,000 marks, the assignments at 375,789,000 marks, *i.e.* a net gain to Prussia of 27,877,000 marks (£1,394,000).

[4] The German law fees (*Rechtsgebühren*) are so high as to really amount to a tax on litigation. For estimates of the proportion of taxation and industrial receipts cp. Von Scheel in Schönberg, 68-69.

is in the rent charges on land, which, together with the parts that are truly either rent or taxation, supply close on £15,000,000 annually. Other sources of the same class are unproductive. Postal service, telegraphs, and railways lead to expenditure rather than profit. Forests produce a small surplus. The tax revenue is just as sharply contrasted with that of England. Salt and opium are the chief contributories, and fiscal monopoly is a prominent agent in the collection. The ordinary excise, customs, and stamps are comparatively unimportant; so is direct taxation, which is so effective in England. On the whole we may say that even in India less than half the net receipts are derived from quasi-private sources of revenue.

§ 7. The preceding facts sufficiently support the general proposition that the economic revenue of the State is financially inferior to that gathered by the tax-collector, and it also seems to hold good that the greater the economic development of a country, the less important is the former. Whether the statement will be applicable to the future is perhaps doubtful. Modern tendencies are in the direction of creating an industrial domain that may rival in value the agricultural domain of earlier times, but the net revenue to be obtained from it will probably be less than would at first appear likely. The cost of constructing the modern state domain and the pressure on the administration to reduce the cost of service to the lowest point that expenses of working will allow, are both hindrances to the use of state industries as an effective relief from the charge of taxation. There is no probability that in the near future the proportion of the public charges to be met by direct levies from the citizens of the State will diminish, more especially when the rapid growth of public expenditure is taken into account.

Taxation will, therefore, next claim our attention, and as the main support of the State's economy will need fuller and more critical investigation than has been necessary with other forms of revenue.

BOOK III

PUBLIC REVENUE (*Continued*

THE PRINCIPLES OF TAXATION

CHAPTER I

DEFINITION AND CLASSIFICATION OF TAXATION

§ 1. THE subject of the present book is undoubtedly the central part of modern finance. Its importance has led English and American writers to regard it as almost the sole topic for discussion. Though this is not true either for England or the United States, and is still more erroneous when other countries are taken into account, yet the existence of such an opinion proves the preponderating influence of taxation in the modern financial organisation. Another evident reason for the great prominence given to this source of state revenue is its close connexion with economics. State expenditure may be looked on as a question of public policy to be decided by the practical judgment of 'that crafty and insidious animal vulgarly called a statesman or politician,' the quasi-private receipts may be treated on the principles of private economy, but taxation raises a series of fundamental questions which involve refined ethical and economic considerations. The effect of any given tax system is a strictly economic question, requiring for its solution frequent reference to the conditions both of production and of distribution. What ought to be the system adopted in each special case must be decided by reference to both moral and economic conditions. Assuming that the partition of the burden should be a just one, we must estimate its true weight and the share really

borne by each citizen before we can venture to pronounce a judgment for or against any proposed arrangement.

The necessity for constantly appealing to the theorems of economists has made the study of taxation almost a part of applied political economy;[1] but, notwithstanding that this is the favourite English method of treatment, it is far better to discuss it as a part of the wider subject of public finance, since its origin and growth are in this way better understood, and the unquestionably close relation between the several departments of public finance can only thus receive due recognition.

§ 2. At the commencement of our examination questions of definition and classification present themselves in embarrassing number. Administrative practice and economic theory are both responsible for this difficulty. Terms apparently of the utmost simplicity have been, and are, used with a variety of meaning that is all the more confusing because of the strong points of connexion between the different uses. Discussions as to the meaning of terms are, it need not be said, hardly ever purely verbal: they in almost every case turn on different conceptions of facts, or different modes of grouping the objects under notice. The literature of finance, especially in Germany, is rich in examples, and some of the best-known doctrines derive a great deal of their authority from some particular application of an ambiguous word. To clear up our terminology, or at least to explain the use of the terms we employ, is an indispensable step in the investigation.

§ 3. First of all we have to settle the meaning of the word 'tax.' This term, so clear and simple to the ordinary citizen, has been very variously defined, sometimes at astonishing length, and often with the, it may be unconscious, design of aiding a particular theory as to the

[1] 'The theory of the incidence of taxation has been generally treated as a branch of the application of economic science to the practical art of government. But really it is an integral part of the general theory of value.' Marshall, 519 n.; cp. Edgeworth, *Economic Journal*, vii. 46.

character of the facts denoted by it. The following definition is, we believe, correct and quite in accordance with the realities of finance and politics: it has the further advantage of not implying unfairly any special view respecting the nature or justice of taxation.

A tax is a compulsory contribution of the wealth of a person or body of persons for the service of the public powers.[1]

Each term in this definition is significant, and helps to explain the object defined. First, a tax is 'compulsory.' This does not mean that all tax revenue is paid unwillingly, but merely that the will of the payer is legally immaterial. The amount, the mode and time of levying, the persons affected, are all determined by the sovereign or its delegate, and individual preferences or dislikes are allowed no place in the act. It thus appears that so-called voluntary taxation is not true taxation, which is plainly the fact; for in the few cases in which it has been tried, society is either in the pre-political stage in which the public economy exists only in a rudimentary form, or the system is one of self-assessment supported by social rather than legal sanction. Gifts may indeed be made by individuals to the State, a circumstance not without importance in the history of finance, but they are at present so rare as hardly to need mention.

Next, a tax is a 'contribution'—that is to say, it involves a sacrifice on the part of the contributor. It is quite possible that some persons may gain through the operation of a tax of which they themselves pay a part; but it is rather the operation of the tax than its payment by the person affected that produces this result. Every tax necessitates a deduction from the wealth of the contributor, even though compensation may be indirectly brought about through its action.

Thirdly, the term 'wealth' has to be understood in a

[1] Sir E. W. Hamilton's definition, 'A tax or rate is an obligatory contribution by persons in respect of, or incidental to, something which they possess or something which they do' (*Memoranda on Classification and Incidence*, 33), seems to be a variant on the above, but hardly covers the case of a poll tax.

wide sense, including 'services' as well as commodities. Military service or forced labour for, say, repairing roads (*corvées*) is taxation quite as much as payment of money or goods. These may be good or bad forms of taxation, but they must be reckoned in the category of taxes.

Again, all taxation is imposed on 'persons.' This necessarily follows from the circumstance that the payment of taxation is a duty, and persons only can be liable to duties. The proposition is apparently inconsistent with the division of taxes into 'personal' and 'real,' and also with the taxation of commodities so often mentioned. There is, however, no opposition between the different uses. The term 'real' taxation refers to the 'object' of taxation; the owner or ultimate bearer is the 'subject' of the tax, and he is a person. Taxation of commodities falls on the consumers or other persons connected with the taxed articles, and a similar analysis will apply to other forms of taxation. The truth, though often forgotten, yet always holds good that a tax must ultimately be paid by some one.[1]

Fifthly, taxation is levied for 'service' or 'benefit. The public economy requires the supply of its wants, and taxation is the mode of meeting whatever proportion of those wants remains unsatisfied from other parts of the public revenue. The produce of taxation has unfortunately been only too often misapplied, and resulted in injury rather than gain; but the tax-imposing body must be regarded as the final arbiter of the justice of its wants. That some requirements are evil makes them none the less requirements in the case either of individuals or of States.

Finally, taxation is for the 'public powers,' *i.e.* it has to meet the wants of both central and local governments. A rate raised by the smallest parish is as much a tax as if it were levied by the Imperial Parliament. All contributions

[1] See on this point the *Memoranda on Classification and Incidence* [C. 9528] issued by the Commission on 'Local Taxation,' especially pp. 85 (Courtney), 112 (Marshall), 160 (Cannan). The position in the text is fully supported by these authorities.

to the various organs of government are taxes in the view of finance, whatever be their administrative name. Special kinds of taxation have been often denounced as being for the benefit of classes or individuals, not for that of the State. Protective taxes, *e.g.*, have incurred this reproach. Such forms of taxation are, however, imposed in the interest, or supposed interest, of the nation, and if they yield any revenue are so far productive of gain to the State. The advantage obtained by the protected producers may be regarded as equivalent to so much public expenditure in their favour. It is generally incapable of being estimated, but this circumstance is of practical rather than theoretical importance. That all taxes of equal pressure are not of equal advantage, either to the State or the community, is too evident to need formal assertion. Otherwise there would be no reason for the selection of any particular forms.

§ 4. The foregoing definition, with the accompanying explanations, conveys all that is essential in the idea of taxation, but the numerous efforts to explain the term deserve some further notice. Many of the ablest writers on the subject have given definitions which substantially agree with that stated in the preceding section. Thus De Parieu defines taxation as 'the charge levied by the State on the property or labour of the citizens, in order to provide for the public expenses'; Roscher asserts that taxes are 'the contributions which individual economies must pay, in consequence of their dependence, to the State, province, commune, etc., or, generally, the particular collective compulsory economy placed over them in order to assist in satisfying the financial needs of the receivers.' According to Cossa, a 'tax is that part of the wealth of private individuals which the authority of the State, province, or municipality appropriates in order to provide for the public expenses incurred for the advantage of the general body of tax-payers.'[1] To these definitions it is not here desirable to add the many others that generally agree with

[1] De Parieu, i. 5; Roscher, § 33; Cossa (Am. Trans.), 50.

them; but we ought to consider some of the doubtful variations in the formal statements of the nature of taxation. One of these is suggested by the last clause of the definition just quoted from Cossa.[1] The phrase 'incurred for the advantage of the general body of tax-payers,' recalls to mind the once-established, and still generally popular, doctrine that taxes are the price paid for the services of the public authorities. This way of looking at the facts was quite in harmony with the political doctrines of the seventeenth and eighteenth centuries. Belief in a compact between the ruler and his subjects led naturally to regarding taxation as simply a payment for service done. The citizen received security and paid its price in taxation. The immediate advantage of this doctrine, as placing a limit to arbitrary exactions and tending to increase security, is apparent, and there is accordingly no reason for surprise when, in some form or other, the idea of exchange is associated with the payment of taxes. In Montesquieu's opinion, 'the revenues of the State are the portion of his property that each citizen gives in order to have security for the remainder, or to enjoy it in comfort.' Here the conception of payment to escape further demands is combined with that of return for services rendered. The French National Assembly gives still another variation in its reference to taxation as 'the common debt of all citizens, and the price of the advantages that society affords them.' From this it is not far to the assertion of Proudhon that 'Taxation is an exchange in which the State gives services and the contributor money.'[2] Hardly distinguishable is the belief that taxation is the insurance premium against the risks of social disorder set

[1] In the later editions of his *Scienza delle Finanze*, Professor Cossa has altered this definition, omitting the last clause, which was intended to emphasise the 'general' nature of taxes (*imposte*) as opposed to 'fees' (*tasse*), regarded by him as special, not at all to assert the 'benefits' theory of taxation, which he rejects.

[2] Montesquieu, Liv. xiii. ch. 1; Stourm in *Dictionnaire d'Économie politique*, art. 'Impôts,' ii. 3; cp. Leroy-Beaulieu, i. 113.

forth in Mirabeau's proposition that 'Taxation is only an advance to obtain protection for social order.' The desire to present a ready justification of the arrangements of society finds an illustration in these attempts to depict taxation as a *quid pro quo*.

To show that this way of explaining taxation is incorrect is not difficult. The assertion that taxes are purely a return for services rendered is plainly untrue. We shall see that there is no possibility of measuring precisely the most important of the benefits rendered by the State. Security against aggression is, literally speaking, an 'incalculable' good. Social order cannot be sold by retail like tea or sugar, and so is it with the other state functions, even the purely economic ones. Indeed, it would be very near the truth to say that the difficulty of applying the normal method of purchase makes a given form of activity suitable for state management; if defence and justice could be readily bought and paid for, we might trust to private enterprise for a sufficient supply. Wherever the benefit to the individual can be even approximately estimated there is a strong presumption in favour of levying the cost incurred from him and converting the tax into a 'fee.' Special reasons may make it desirable that this charge should be compulsory. The citizen may be so negligent of his true interest as to omit obtaining the best appliances for the purposes of health or education, but even in such cases there is also a general interest which furnishes the principal ground for the intervention of the State.

The opposition between free payment and taxation is too important to be evaded by the introduction of a vague idea of exchange of services as including both, and any definition of taxation that implies, or expressly states, this combination is so far erroneous. Like the general doctrine of the social contract, its practical convenience as a weapon on the side of liberty cannot conceal its scientific weakness. The equivalence between the amount of taxes paid and the benefits obtained is rather to be found in the case of the

community as a whole than of any special part of it. Looking at the public agencies from this point of view, it is well to consider whether the advantages of government are a compensation for its cost, and this test should be steadily applied in judging the merits of any proposed expenditure. The question, in truth, belongs to that department of public finance. Once expenditure has been incurred, the imposition of taxation in order to meet it is a matter of course. We have accordingly considered it in its fit connexion.[1] In any case, to introduce what is at best a highly disputable doctrine into the definition of so important a term is altogether a mistake.

§ 5. Other definitions of taxation fail through excessive vagueness. We gain little by being told that taxation is 'a public charge, a duty imposed on certain things.'[2] Very often one or more of the essential elements is omitted. Thus the fact of taxation falling solely on persons is neglected in the definition of taxes as 'the enforced proportional contribution of persons or property levied by the authority of the State for the support of government and for all public needs.'[3] Besides the error of including 'property' as a subject of taxation, this definition brings in the unessential principle of 'proportionality,' and would therefore exclude large groups of what are universally regarded as taxes. This is a very common defect in the definitions of the term, due to the desire to give an exhaustive account of its attributes, or to bring some favourite theory into its general conception. Professor Ely's elaborate account, like those of many German writers, illustrates this danger.[4] The real function of a definition is to give a clear

[1] See Bk. i. ch. 8, § 4 sq.

[2] The definition of the dictionary of the French Academy.

[3] Quoted from Cooley by Ely. *Taxation*, 4.

[4] 'Taxes are simply one-sided transfers of economic goods or services demanded of the citizens, and occasionally of those who are not citizens, but who nevertheless are within the reach of the taxing power, by the constituted authorities of the land for meeting the expenses of government or for some other purpose, with the intention that a common burden shall be maintained by common contributions or sacrifices.' *Taxation*, 6–7. Cp. the definition

idea of the nature and limits of the phenomenon denoted by the term, not to convey in a formal statement all that is known about it, still less to prejudge the questions that may arise in the course of further inquiry.

§ 6. The etymologies of the words employed in different languages to denote this class of public contributions are full of instruction. The English 'tax,' as also its equivalent in local finance, 'rate,'[1] suggests the estimation or fixing of the amount of charge. So does the German '*Schätzung*.' The idea of assistance or advantage to the State is foremost in the French '*aide*' and the German '*Steuer*.' That of compulsion is primary in '*impôt*' and '*Auflage*.' The surrender by the payer is connoted in '*tributum*,' '*dazio*,' and '*Abgabe*,' while finally the origin of taxation in voluntary payment is evidenced by the words '*donum*' and '*benevolence*.' Minute investigation may show that there are differences in the nature of the charges described by these several names, but, speaking broadly, they all cover what we regard as taxation, and help to justify the definition given above.[2]

§ 7. Having determined the meaning of 'taxation,' it next becomes necessary to understand its chief classifications and the technical terms employed respecting it. First, we may notice the term 'subject,' which is conveniently used to denote the person who bears its burden, and who must be distinguished from the immediate payer—*e.g.* the importer of wine in England pays the duty on it, but the 'subjects' of the wine duties are the consumers so far as the charge is really a pressure on them. The 'subject' and the payer may or may not be the same according to the particular circumstances.

given by Wagner, ii. 210, which brings in the complication of a distinction between 'pure financial' and 'politico-social' taxation; also i. 499–500, where 'taxes' are marked off from 'fees' (*Gebühren*) by their 'general' character.

[1] There seems to be no foundation for Mr. Cannan's suggestion that the 'rate' is 'apportioned,' while the 'tax' is a 'percentage' charge (*History of Local Rates*, 4-5). The only plausibility that it possesses is due to the fact that in the United Kingdom rates are practically a single-tax.

[2] Cp. Roscher, § 33; Wagner, ii. 223.

As the 'subject' of taxation is the person affected, so the 'object' is the thing or fact on which it is imposed.[1] Thus, in the example just given of the wine duties, the commodity wine would be the object of the duty. Even where taxation is said to be 'personal' it is assessed on some object as 'income' or 'produce,' or in the extreme instance of a capitation or poll tax on the person as a physical body. Confusion between the 'subject' and 'object' is the cause of the belief that some taxation does not fall on persons.[2]

The 'source' of taxation has somewhat the same relation to its 'object' as the ultimate bearer or subject to the immediate payer. The fund created by taxation is derived from the resources of the community, *i.e.* as we shall see from the income, or in special instances the property, of the 'subjects.' There has been much dispute as to the real 'source' of the tax-revenue that will need consideration later on, but there can be no doubt as to the proper use of the term 'source' in respect to taxation. It is, perhaps, unnecessary to mention the terms 'unit' and 'rate,' which are employed, the former to describe the quantity of the object taken as a standard, the latter the amount of taxation per 'unit.' Where commodities are taxed the unit will be a measure of weight, *e.g.* the lb., as in the British tea duty, or contents, as the gallon in the wine duty, or length, as in the old duties on cottons. A sum of the standard money is the commonest, as in the system of *ad valorem* duties.[3]

[1] Professor Seligman (*Political Science Quarterly*, vii. 715) demurs to this use of the terms 'subject' and 'object,' but it is convenient to have a word to denote the ultimate bearer of the burden of taxation, and 'subject' seems to be the only one at hand for the purpose, while 'object' is employed by eighteenth century writers to denote the commodities placed under taxation; *e.g.* Hamilton, *Report on Manufactures* (ed. Taussig), 78; A. Young, *Tour in Ireland* (Bohn ed.), ii. 230.

[2] This mistake is somewhat like that committed by Blackstone in speaking of 'the rights of things' (*Jus rerum*).

[3] Cp. Roscher, § 33; Wagner, ii. 226–8; Schäffle, *Steuerpolitik*, 52–3, for the use of these terms in German finance. The use of 'subject' in the text differs from that of the above writers, as they apply it to the person legally responsible for payment.

§ 8. A much more important set of terms is that connected with the classification of taxation. The division and grouping of the several kinds of taxes have been varied to suit particular financial systems, and much of the general discussions on the subject is concerned with the comparative merits of these arrangements, and the extent to which they conform to the natural order, so far as it can be said to exist. A preliminary notice of some of the more common distinctions is desirable at the present stage.

One of the most widely known and frequently used divisions of taxation is that into 'direct' and 'indirect'; unfortunately it is used in different senses, though with several points of connexion. That most familiar to English readers is stated by J. S. Mill in the following terms:—

'Taxes are either direct or indirect. A direct tax is one, which is demanded from the very persons who, it is intended or desired, should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another.'[1]

The difference is here made to turn on the mode of incidence, a matter often very difficult to determine, and changing with the special circumstances of each case. Whatever be its economical importance, it is evidently useless for administrative purposes, and probably owes its origin to the peculiar theory of the Physiocrats respecting the 'source' of taxation.

A natural result has been that practical financiers have adopted a different basis of distinction, and regard those taxes as direct which are levied on permanent and recurring occasions, while charges on occasional and particular events are placed under the category of indirect taxation. On either method the income tax would be 'direct,' and the excise and customs 'indirect': the 'death duties' would be 'direct' from Mill's point of view, and 'indirect' in the administrative sense. The vagueness of the terms has

[1] *Principles*, Bk. v. ch. 3, § 1.

led to a number of further applications differing from the important ones just mentioned. With some writers taxes on possession are 'direct,' taxes on consumption 'indirect': with others production is substituted for possession, while a third class would regard taxation of income as direct, imposts on expenditure being indirect.[1]

Another division is that into 'taxes on revenue' and 'taxes on capital,' or, perhaps better, on 'property.' The former are paid out of the annual national production; the latter encroach on the accumulated wealth of the society. But in qualification of this statement it must be added that most of the actual property or capital taxes are so only in name, being really paid out of the income of the persons subject to the charge. There is thus a discordance between the practical and scientific use of these terms as great as in the case of direct and indirect taxation.

Taxes are often said to be either 'real' or 'personal,' and attempts have been made to distribute them into two classes on this basis. Personal taxes are those in which the person is taken note of in assessment. They require lists of the tax-payers (*rôles nominatives*, in the language of French administrators). Real taxes are assessed on objects other than persons, and without direct reference to the owners or possessors. Capitation and income taxes are 'personal'; taxes on land, houses, or goods are 'real.' The use of these terms has the inconvenience, already noticed, of obscuring the fact that all taxation is in the last resort on persons, and further raises a particular form of levy into undue importance. An income tax is certainly personal, but Schedule A of the English income tax is very similar to the French *impôt foncier*, that is as certainly 'real.'

[1] The questions here raised are further discussed in Bk. iii. ch. 4, 'The Tax System, its Forms.' See for a full treatment of the history of the terms a valuable article on 'Direct and Indirect Taxes in Economic Literature,' by Professor C. J. Bullock, *Political Science Quarterly*, xiii. 442–476. The use of the term 'direct' in the Constitution of the United States has given rise to much controversy, culminating in the decision of the Supreme Court on the income tax of 1894, pronouncing it invalid as being 'direct.'

In respect to the mode of assessment taxes may be either 'rated' or 'apportioned.'[1] In the former class the charge per unit is fixed, but the total yield is always uncertain, depending as it does on the number of units that pay. An apportioned tax is one the total amount of which is fixed the shares being apportioned among the objects that are charged. As examples the English income tax and the French *impôt foncier* will again serve. The former is 'rated,' the latter 'apportioned,' being so divided among the departments as to make up the previously fixed amount. This method is decidedly the more primitive: it has disappeared long ago from the English system, and will probably meet the same fate elsewhere.[2]

§ 9. The foregoing distinctions are too important to be passed over, but they are also too imperfect to be of much use in a scientific classification of taxes. Particular aspects of taxation, the administrative peculiarities of certain countries, and obsolete or imperfect theories have been the causes of their employment. It is accordingly advisable to consider the subject from a more general point of view in order, as far as possible, to reach a natural arrangement.

In choosing the principle of grouping we have to make a selection between two contrasted systems which may be distinguished as (1) the economical and theoretical, and (2) the empirical or fiscal modes.

The first mentioned depends on the economical theory of the distribution of wealth, and can be traced back at least to Adam Smith. He opens his discussion of taxation by asserting that 'the private revenue of individuals arise ultimately from three different sources—rent, profit, and wages,' and proceeds, 'every tax must finally be paid from

[1] These terms seem to be the least unsuitable equivalents of the French *impôts de quotité* and *impôts de repartition*. Professor Seligman prefers the American term 'percentage' to 'rated,' but where the units are of unequal value its use would be incorrect.

[2] The old English 'tenths and fifteenths' and the later 'subsidies' were apportioned, Dowell, i. 88. The recent change in the French house duty is an illustration of the tendency to abandon the system.

one or other of those different sources of revenue, or from all of them indifferently. . . . The particular consideration of each of these different sorts will divide the second part of the present chapter into four articles.'[1] Nothing can be plainer and simpler in appearance than this arrangement. The economic shares in distribution are regarded as so many sources of revenue, on one or more of which every tax must fall. The later analysis of profit into the component parts of 'interest' and 'employer's gain' would add one further source, but would not otherwise disturb the treatment.[2] The great attractions of this method are its simplicity and the facilities that it affords for employing the propositions of economics in deducing the effects of taxation. To reduce the subject into 'four articles,' even with 'several other subdivisions,' promises a welcome abridgment of labour. English economists in treating of taxation have therefore intended, as far as possible, to follow this course. Ricardo and J. S. Mill are the most prominent examples. But on closer examination it appears that neither of them, nor even Adam Smith himself, could adhere consistently to this over-simple grouping. In Ricardo's hands the subject requires eleven chapters, several of which consider the effects of taxes on land, houses, raw produce, and gold, in addition to those on the primary sources of rent, profit, and wages. Mill goes further and formally limits the division of taxes according to the economic source on which they are imposed to the case of direct taxation on income.[3] The taxation of commodities and such taxes as those on contracts and on communication are quite outside it. But the *Wealth of Nations* affords a stronger proof of the insufficiency of the ground of division

[1] *Wealth of Nations*, 347.

[2] It is noteworthy that Adam Smith makes this separation in his account of taxes on profit: 'The revenue or profit arising from stock naturally divides itself into two parts, that which pays the interest and which belongs to the owner of the stock, and that surplus part which is over and above what is necessary for paying the interest,' 357.

[3] Bk. v. ch. 3, § 1.

selected by its author. Sections devoted to taxes on produce of land, on the profit rent, and the ground rent of houses, to capitation taxes, and taxes on commodities, break up the compact order that the introduction holds out. It is evident that the subject-matter refused to fit into the limited groups that the economic classification required, and the sound common sense so characteristic of Adam Smith is shown by his deviations from the theoretic lines previously traced out by him.

Much of the difficulty arises from the fact that taxation always has persons for its 'subjects,' and they frequently derive their income—the normal 'source' of taxation—from more than one of the different economic shares. The citizen is not a pure rent, interest, or wages receiver; he often combines all three in his annual receipts. Again, the most prominent external feature of taxation is the 'objects' on which it is levied. These are, however, very many, and it is often beyond the power of analysis to decompose the charge on some commodity or form of receipt into its economic constituents, *e.g.* the produce of land may be due to the co-operation of natural agents, capital, labour, and directing ability, but to say how much of the taxation imposed on the result is to be assigned to each factor is quite impossible.

The obvious conclusion is that the classification is unsuitable. It is often convenient to use the economic theorems respecting rent, wages, etc., in our investigations of the effects of taxation, even though we should never meet in fact with the pure taxes on those parts of the product. For the problems of finance it is also necessary to remember that these preliminary inquiries are but steps towards the final result, which must deal with realities and not with imaginary and hypothetical cases.

§ 10. The defects of the economical mode of classification lead us to turn to what we have entitled the 'empirical' or 'fiscal' one, which takes the actual kinds of taxation and arranges them in the most convenient way. To this

procedure it may at once be objected that as each country has its own tax system, varying from time to time, we cannot attain to a general arrangement applicable to all cases. The classification of taxes suited for ancient Rome would be inadequate in modern England, and even confining attention to the present day, the Indian and British tax systems cannot be easily reduced to the same classification. This effect of temporary circumstances in limiting general principles has been already noticed,[1] and it does at first sight raise difficulties in the effort to prepare a natural grouping of taxes. A ready mode of escape is, however, to be found. The terms and minute details of taxation vary greatly at different times and places, but this does not preclude the existence of large categories of taxation, possible in all countries, and found in somewhat different forms in many. The Indian land revenues differ from the English land tax and also from the French *impôt foncier*, but in all three countries there is 'taxation of land,' which offers a general title, under which they may be placed in company with the Roman provincial tax and several others. Like treatment can be applied to different forms of taxes on the produce of industry, and so in other cases.

The question next arises, How far should this process be carried, and what general categories can we form? Rau has boldly grouped all taxes under the two heads of 'estimated taxes' (*Schätzungen*) usually charged on goods, and 'taxes on expenditure' (*Aufwandsteuern*), which does not carry us much beyond the rude divisions mentioned in § 8. Hoffmann prefers the division into taxes on possession (*Besitz*) and taxes on acts (*Handlungen*), while Cohn accepts the tripartite arrangement of Wagner into taxes on (*a*) acquisition (*Erwerb*), (*b*) possession (*Besitz*), and (*c*) consumption (*Verbrauch*).[2] De Parieu carries out the division

[1] See Introduction, ch. 1, § 8.

[2] Rau, i. § 292; Hoffmann, *Lehre von den Steuern*, 69; Cohn, § 332; Wagner, ii. 233 sq., 515.

more minutely, and forms five classes of taxes, viz. (1) on persons, (2) on wealth, (3) on enjoyment, (4) on consumption, (5) on acts. In defence of this arrangement he argues that, like all natural classifications, it allows of an indefinite margin between each adjacent group, and that it further harmonises with the administrative division between direct and indirect taxation, classes 1, 2, and 3 belonging to the former, and classes 4 and 5 to the latter category.[1]

All the preceding classifications appear to have at least two defects: for (1) they simply deal with certain external features of taxes, and do not take note of their essential characteristics, and (2) like the otherwise very different arrangement of Adam Smith, they are too simple for the complexity of the facts to which they are applied. Hock has attempted to avoid this defect. He starts from the untenable position that taxation is a compensation for state services. These services are, he thinks, of three kinds, to wit: (1) protection of person, (2) protection of property, and (3) the performance of special services. To each corresponds a 'primitive tax' (*Ursteuer*): these are (1) personal taxes, (2) income taxes, (3) taxes for special services rendered.[2] The practical difficulties in levying these taxes in their pure form leads to the use of other taxes as substitutes (*Surrogate*) in the form of taxes on (*a*) consumption, (*b*) product, (*c*) customs, (*d*) special income taxes, (*e*) fees and charges on occupations.[3]

Though it is plain that the basis of Hock's division is unsound, it yet has the merit of suggesting the best way of reaching a truly natural arrangement. The distinction between primitive and derived taxes is a valuable one, and

[1] De Parieu, i. 12–14.

[2] *Abgaben und Schulden*, 15–17.

[3] *Ib.* 82 sq. Stein's classification of taxes into (1) direct, (2) indirect, and (3) income taxes—the first falling on capital, the second on labour, and the last on individual economic activity—is decidedly unsatisfactory; nor are his subdivisions better. Thus the direct taxes are divided by him into those on (*a*) produce, (*b*) acquisition, (*c*) commerce, but the land tax comes under (*a*) and the industry taxes under (*b*), though the latter are evidently produce taxes. Stein, ii. 495 sq., and iii. *passim*.

can be so used as to combine the economical and empirical methods of grouping in a consistent arrangement.[1]

§ 11. The position of Adam Smith that taxation must be derived from the constituents of private income is, broadly speaking, correct. Where it falls on property there is a diminution of the national wealth which, if continued, must prove destructive. A true instinct, therefore, prompted him in his effort to analyse taxes into those on rent, on wages, and on profit. On the other hand it is equally true that the 'objects' of taxation do not easily allow of this analysis. Between the taxes of economical theory and the taxes of actual life there is a gulf that appears hard to bridge over, and one that has retarded the progress of financial science.

This difficulty is at all events extenuated by the circumstance that though the abstract economic taxes are not met with in fact, they are not wholly imaginary. A tax on economic rent has some and often considerable resemblance to a land tax, or, to put it the other way, a land tax often tends to become a tax on rent. The 'tax on profit' of the economic text-books bears a like relation to the taxes on business, of which Schedule D of the English income tax, the Prussian *Gewerbesteuer*, and the French *Patente* may be taken as specimens. So with the wages tax, in relation to actual capitation taxes, or the late *Classensteuer* of Prussia. If now we regard taxes on the factors of production, and therefore on the shares in distribution, as 'primary,' we have a basis from which to proceed to the investigation of those secondary taxes that are placed on other 'objects.' By grouping together the various taxes on land we can consider the play of financial forces in the case of rent. The industrial taxes will similarly enable us to see the working of charges on interest and profit, and finally poll

[1] The question of classification is discussed in the *Memoranda on Classification and Incidence* [C. 9528], but the only result reached is a negative one. The attempt to divide taxes into (*a*) those incidental to the ownership occupation, or transfer of property, and (*b*) those 'not incidental to property,' was thoroughly exposed, and was abandoned by the Commission.

and capitation taxes will perform the same service for taxes on wages.

The economic mode of arrangement assigns a place to taxes on income or revenue which may be regarded as a combination of all the primary forms. It may in certain cases be admissible to break up an income tax into its component parts, just as, on the other hand, it may be well to combine a series of taxes that together make up an income tax. Thus the five schedules of the English income tax or the four of the Italian one might be separately treated, or again the 'four direct contributions' of the French system might be taken in combination as nearly equivalent to a general income tax.[1] Still, it is necessary to consider the fiscal bearings of general income and property taxes, and this discussion most fitly follows the examination of the taxes on component parts of income.

When the 'primary,' and, if the phrase be admissible, 'quasi-primary' taxes have been discussed, there remain no small number of other charges. The whole elaborate system of taxation on commodities that has so large a place in every country must be dealt with. It may be regarded as taxation of consumption, or of expenditure, but for practical purposes it includes the two great departments known to English fiscal practice as 'excise' and 'customs.' So far the taxes enumerated have appeared to fall on the production, the distribution, or the consumption of wealth; those that directly affect the remaining economic process of circulation must also be noticed. Taxes on transport and communications come under this head; so does the yet more important class of taxes on the transfer of property and the transactions of commerce, *i.e.* the 'taxes on acts' of De Parieu's arrangement. The taxation of succession after death may be treated as a particular case of transfer, but it also has affinities with property and income taxes which must be carefully considered. In like

[1] They are (1) *Contribution foncière*, (2) *Contribution mobilière*, (3) *Contribution des portes et fenêtres*, (4) *Patentes*.

manner taxes on necessary commodities often resemble in their effects a tax on wages, as Ricardo with some exaggeration urged. The other secondary taxes have similar reactions on the constituents of income, but, nevertheless, their separate treatment is desirable, and indeed unavoidable.

§ 12. We have now obtained what appears, on the whole, a satisfactory distribution of the several taxes. Briefly recapitulated it is as follows: The main division is into 'primary' and 'secondary.' The primary taxes comprise those on land, on business and capital, on persons and on labourers' earnings. The combination of these primary forms gives us the general income and property taxes which come next in order. Passing to the secondary forms of taxation we find (1) taxes on commodities, including both excises and customs, (2) taxes on communication and transport, (3) the remaining taxes on commerce and legal transactions, (4) taxes on transfer of property, (5) succession duties.

But the discussion of the several taxes in the foregoing order must be postponed until we have studied the operation of taxation in general and the conditions required for its satisfactory working. No single tax can be rightly appreciated without reference to the financial system of which it forms a part. The remaining chapters of the present Book will therefore be devoted to a study of the characteristics of taxation in general and the principles that should regulate its application. In this part of finance we meet with difficult theoretical and practical questions which will require the utmost attention for their proper understanding. On some points opinion is sharply divided, and consequently, while endeavouring to reach a definite judgment on each disputed question, we shall endeavour to obtain a clear conception of the grounds on which opposing views are based.

CHAPTER II

THE GENERAL FEATURES OF TAXATION

§ 1. THE increasing importance of taxation as a mode of supplying the public wants is a conspicuous feature in financial development. It is partly attributable to the decline of the earlier forms of revenue, but far more to the great and continuous growth of expenditure. The modern State is dependent on taxation to an extent unknown in mediæval times. Hence all questions connected with this department of finance have an enhanced interest. Errors on the subject, or mistakes on the part of practical financiers, tend to become more and more serious and the need of a careful study of the general features of the tax system is greater. Without a true appreciation of the conditions under which it works, it is hopeless to expect the adoption of a wise policy, or determination in applying it. Practical sagacity has its part—and no small one—in successful financial management, but it is all the more effective when enlightened by the study of principles. The complications of modern financial systems make it advisable to note their chief characteristics before discussing the comparative merits of the rules proposed for their regulation. The phenomena are not so simple as to admit of regulation by a single mechanical rule, and the real bearing of the different propositions will be best understood after some acquaintance with the subject-matter to which

they are applied, and the difficulties that surround them. The interaction of state and national economy brought about by taxation produces further complications that will not allow of hasty treatment. We shall therefore begin by a study of some of the general features of the tax-system, a knowledge of which is essential for forming a correct judgment respecting its regulation.

§ 2. Looked at in a broad general way, the first circumstance that strikes the observer is the fact that taxation means the subtraction of so much wealth from individual enjoyment or use. The definition given in the last chapter seeks to express this fact by pointing out that taxes are contributed by persons from their wealth for the public service. State expenditure is devoted to the supply of certain wants of the community or nation by the action of the public powers. These, like all other agencies, cannot be obtained without cost, partly met by the economic or quasi-private revenue, but leaving a balance to be supplied by taxation. It thus appears that there is an element of truth in the description of taxation as 'the expenses of production of the State'; the phrase, however, suggests too close an analogy with industrial enterprises, in which the expenses are repaid out of the product. In respect to public services, the benefits will in normal cases largely exceed the cost, but the method of calculation is not so easily applied, nor is the object in view the attainment of profit.

The proposition that taxation is the form of cost or expense proves that it is so far an evil in the sense that every sacrifice is such. It may be necessary or advisable, but could the object be otherwise accomplished it would be still better. Any saving in the expense of working the State enables a larger amount to be left in the possession of the tax-payers, and to that extent improves their economical position. The former statement of this very plain fact might appear superfluous were it not for the existence of strong popular prejudices in favour of the expenditure of

funds derived from taxation. 'Government expenditure gives employment and benefits the labourers' is the commonest form in which this belief is asserted. Without entering into the question how far such expenditure does really reach the labourers, it is sufficient to reply that the persons from whom the funds have been taken by the tax-collector would certainly have made use of them, either in the employment of labour, or the purchase of commodities. The belief that taxation returns in 'a fertilising shower' was rightly regarded by Bastiat as one of the errors arising from defective observation.[1] Hardly worthy of refutation as a theoretic doctrine, its evil effect, particularly in democratic societies, in producing extravagant expenditure is not to be overlooked.

The idea that 'taxation is the best form of investment' is placed by Bastiat in the same category as the gross fallacy just refuted, but it admits of a more favourable interpretation. If it be said that the taxation required for the national defence, the maintenance of justice, and the necessary functions of the State, has been invested in the best manner and yields a good return, the assertion is substantially true, though perhaps expressed in a misleading way, as the State cannot be regarded as a mere industrial concern. Further, as Leroy-Beaulieu points out, the proceeds of taxation, if employed in public works, may yield a satisfactory profit, and thus be, in the literal sense, 'a good investment.' The expediency of such investment belongs rather to the subject of expenditure than to that of taxation, but we may remark that, if public works are likely to be profitable, it seems better on the whole to raise the requisite funds by a loan, to be repaid through the agency of a sinking fund. To use taxation for this purpose is almost equivalent to a 'forced loan.'[2]

[1] Bastiat, *Œuvres*, v. 344 sq. ; cp. Leroy-Beaulieu, i. 118.

[2] Leroy-Beaulieu, i. 125–6. See above. Bk. i. ch. 8, §§ 2, 3. Also Bk. v. ch. 5, for a discussion of the expediency of public borrowing for this object.

§ 3. The consideration of taxation as reproductive in the way of investment suggests the further question of the possibility of its productiveness through reaction on the national economy. If the use of the funds raised by taxation can prove beneficial, may not the effect of taxation itself on production be sometimes good? This view is expressed in the maxim discussed by Hume, 'that every new tax creates a new ability in the subject to bear it, and that each increase of public burdens increases proportionably the industry of the people,' which, he thinks, 'must be owned, when kept within certain bounds, to have some foundation in reason and experience.'[1]

Natural disadvantages sometimes stimulate industry, why then should not artificial ones have the same effect? The most remarkable economic progress has been made in countries where man has had to exert himself in consequence of the parsimony of nature, not in those that possessed the richest and most fertile lands. A judicious use of the engine of taxation would, it might be thought, have a similar effect on the disposition of the people. Such was the opinion of McCulloch, who maintained that the heavy taxation of England, during the French wars (1793–1815), was one of the causes of the growth of wealth at that time, since it stimulated industry and the spirit of enterprise and invention.[2]

The doctrine in this rather extreme form admits of an easy refutation; for if taxes create a new ability on the part of the payers there can be no determinable limit to their useful employment. A wise government would increase taxation indefinitely, and thereby augment the national possessions. The process of creating fresh wealth by simply taking it from the producers is so evidently impossible that its advocates hesitate to carry their view to its logical outcome. There is in truth a two-fold fallacy in the argument.

[1] *Essays* (ed. Green and Grose), i. 356. Prof. Seligman (*Essays*, 86 n.) is mistaken in supposing that the doctrine is here 'ascribed' to Hume, as any reader of the text can see.

[2] *Taxation and Funding*, 7 sq.

In the first place, natural obstacles do not, in general, stimulate to exertion; economic development is not greatest among the Eskimos, or the Fuegians, as it ought to be on this hypothesis. Some natural difficulties urge man to action, but others reduce him to torpor, and check the first steps towards civilisation. The influence of natural disadvantages in promoting the growth of wealth is rather by their indirect effect on the physical and mental qualities of those subject to them, not by the economic loss that they occasion. Secondly, the analogy between natural and artificial obstacles is defective. It does not follow, because men work more strenuously (and this is doubtful) to till a barren soil, that therefore they will exert themselves the harder the more they suffer from the incursions of marauders. The greatest promotive of industry is security, and protection from arbitrary or oppressive taxation is but one form of that 'protection against the Government' on which Mill justly insists as more important even than 'protection by the Government.'[1]

Later on, however, Mill appears to adopt a milder form of McCulloch's view. When examining the effect of a tax on profits, he declares that 'It may operate in different ways. The curtailment of profit, and the consequent increased difficulty in making a fortune, or obtaining a subsistence by the employment of capital, may act as a stimulus to inventions, and to the use of them when made. . . . Profits may rise . . . sufficiently to make up for all that is taken from them by the tax. In that case the tax will have been realised without loss to any one.'[2] Such a result, though possible, is extremely unlikely, as the additional production in consequence of the tax would itself be subject to taxation. A low rate of profit may lead to the introduction of economising expedients, but the expectation of a high rate is far more effective in increasing production. There is just as much, and just as little, truth in the belief that low profits encourage industry, as in the similar beliefs

[1] *Principles*, Bk. i. ch. 7, § 6. [2] *Ib.* Bk. v. ch. 3, § 3.

that low wages make the workman and high rents make the farmer industrious.[1] Some special examples have been brought forward in support of the position that certain forms of taxation stimulate invention. McCulloch cites that of the Scotch distillers, who, under the influence of a spirit duty, assessed according to the contents of the vessels, so improved their processes by economy of the time spent in distilling, that instead of taking a week, they in a few years required only three minutes, and thereby were able to bear a duty nearly forty times as great as at first. Somewhat similar improvements have been introduced into the Continental beet-root sugar industry in consequence of the method of imposition, which assumes a certain yield and charges duty only on that amount, leaving any excess free.[2] What is really striking in these cases is the fact that invention has been stimulated, not by the duty, but by the possibility of escaping it: the imperfect form of assessment has encouraged efforts in this direction that would cease if the true return were brought under taxation. They do not show in the slightest that the progress of invention is greater in a taxed industry than in one free from taxation. All antecedent probability, and all actual experience, go to prove the opposite.[3] One great impediment to the use of new processes is the surveillance that taxation renders necessary.

The result of the preceding discussion is, briefly, that any compensating effect of taxation in increasing production is extremely doubtful, and is at best so small, and occurs in so few cases, as not to form an element worthy of entering into the rational calculations of the financier. The raising

[1] For a good refutation of the idea that low wages make workmen active, see *Wealth of Nations*, 34. Arthur Young approved of high rents as promoting industry, *Northern Tour*, ii. 80–83; and Sir J. Caird deprecated under-letting, but wisely remarked that the opposite error of overletting is much more hurtful. *English Agriculture*, 477.

[2] McCulloch, 151–2; Leroy-Beaulieu, i. 258–260.

[3] For further discussion on this point, see ch. 4 of the present Book, also Bk. iv. chs. 6, 7.

of compulsory revenue means so much loss to the payers and to the community, for which the only return obtained is the benefit resulting from the efficient execution of state functions. Any doctrine that removes attention from this cardinal fact is erroneous in principle, and may lead to serious practical evils.

§ 4. Nor does taxation only mean the withdrawal of the amount required by the public powers from the disposable funds of the subjects of taxation. It may, and often does, take much more. In all countries the cost of collection is no inconsiderable item, which must be added to the actual amounts needed by the state departments unless it be regarded as an additional state function. In either view it increases the burden to the payers. Consequently, one of the most generally recognised maxims of finance is that which prescribes that 'Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the State.'[1] This rule, declared by Wagner[2] to be simply the application of the general principle of economy to public finance, has two distinct applications: (1) as regards the State itself, the aim of securing the best return in amount of taxation for the expense incurred in collection is very plain, but even when this is realised there is (2) the still more important object of not inflicting indirect loss on the subjects, either by the obstruction of industry that taxation causes, or by the inconvenience that the regulations incident to the system of collection may produce. Some forms of taxation are much more oppressive in these respects than others, and one of the principal tasks of financial practice is to discover the least burdensome modes.

The public economy depends ultimately on the national economy; anything that reduces the economic power of the

[1] *Wealth of Nations*, 348. The fourth of Adam Smith's 'classical' rules See Bk. iii. ch. 7.

[2] Wagner, ii. 467. In Jevons's phrase, 'The maximisation of utility.'

individual citizens is an injury to the State. A system of taxation that diminishes the revenue of the subjects without a corresponding return to the public treasury is certain before long to show its effect in reduced receipts from taxation.

A comparison of English taxation as it existed in 1820 with that now in force proves how much may be gained by a determination to conform to the rule of 'economy.'[1] But even in the best existing systems of finance there is a large amount of waste, some of it unavoidable. The raising of such a sum as £120,000,000 in the course of a year cannot be accomplished without much interference with industry and trade and a great deal of annoyance to individuals. From a purely material point of view this canon of 'economy' is probably the most important in fiscal science, and no efforts should be spared to secure the closest observance of it that existing conditions permit.

§ 5. The supply of state wants by taxation is then, it is plain, a charge on the collective resources of the community. Finance is no exception to the general rule that it is impossible to obtain something out of nothing. Prudent management may make the available resources go farther than they otherwise would. The financier, like the mechanician, proves his ability by the direction, not by the creation, of force, and especially by reducing to a minimum the loss through friction. But having decided that taxation is a charge on the national resources, there is room for further inquiry as to the precise fund on which it falls. We have already mentioned Adam Smith's opinion that it must be derived from the shares of revenue. Ricardo declares that 'Taxes are always ultimately paid either from the capital or from the revenue of the country,'[2] and expands his statement by pointing out that the proceeds of a tax must curtail consumption, increase production, or reduce

[1] See on this Dowell, ii. 249, 261, who quotes Sydney Smith's humorous account.

[2] *Works* (ed. McCulloch), 87.

capital, *i.e.* 'impair the fund allotted to productive consumption.' From this he concludes that taxation should be imposed on revenue rather than on capital, since the latter form of tax tends to check future production. Some writers have even raised this into a maxim of finance.[1] The danger of hindering the growth of capital is apparent, though as capital is derived from revenue it is not easy to avoid taxing it to some extent. 'To provide that taxation shall fall entirely on income and not at all on capital is,' says Mill, 'beyond the power of any system of fiscal arrangements.'[2] In actual economic life the line between capital and non-capital is not so fixed and rigid as the text-book definitions would make us believe.[3] Any tax is certain to take some wealth that would otherwise have been devoted to the aid of production, and also some that, if left to the taxpayers, would have been consumed unproductively. How much will come from each source is not easily determinable.

The distinction between capital and revenue is, besides, not quite the same when considered from the national rather than the individual point of view. Much individual capital is not national capital, and this is likewise true of revenue; but for the financier it is national capital and revenue that need attention. Any pressure on the most important auxiliary of production is as far as possible to be avoided; but when capital is rapidly increasing, a tax that appears to trench on individual capital, as *e.g.* the English Death Duties, is not open to the objection of reducing national capital in the same degree as it would be in a poor and unprogressive country. Taxation is drawn from the total stock of wealth, including

[1] 'Tout impôt doit porter sur le revenu, et non sur le capital' is the first of Sismondi's maxims. *Nouveaux Principes*, Liv. vi. ch. 2.

[2] Bk. v. ch. 2, § 7.

[3] See Marshall, *Principles*, Bk. ii. ch. 4, for a discussion of the diverse application of the term 'capital.' 'There is, and from the nature of the case there must be, something artificial in every broad distinction between capital in general and other forms of wealth.' *Ib.* 'Preface' to 3rd. ed., vi.

at any given time both capital and revenue. The real aim should be to so direct it as to interfere to the smallest extent with the action of the forces that promote accumulation. Heavy taxation will always be injurious in this respect. If imposed on revenue it reduces the fund from which capital comes, and may even lead to direct encroachments on individual capital: if on capital it leaves revenue free to partially fill up the gap that it has made. There is no impassable barrier between the two categories of wealth; any action on one will, in all probability, extend to the other.[1]

In addition to the productive capital and annual new production, every civilised society possesses a large mass of wealth in process of use, 'stock reserved for immediate consumption' as Adam Smith calls it, 'consumers' capital' in Sidgwick's phrase. There is in this 'stock' a further source on which taxation may fall without injuriously affecting the productive powers of the community. In fact, we can fairly say that no less comprehensive term will suffice to describe the source of taxation than that already employed, viz. 'the collective wealth' of the country. But in actual societies in their normal condition taxation is derived from the national revenue, some of which would have been transformed into capital. Nothing but a national crisis would justify taxation so heavy as to absorb the free income of the society and reduce the sum of its accumulated wealth.

§ 6. A celebrated doctrine has carried still further this limitation, and maintained that all taxation should be levied on the net, as opposed to the gross, income. Net income is asserted to be the only disposable fund for the purpose. Gross income includes the necessary expenses of maintaining the citizens and replacing the national capital. To touch on that part of the gross receipts would be a blow to the industrial organisation, inasmuch as it is an essential requisite for the society being continued

[1] See Bk. v. ch. 5, § 9, for further treatment of this point.

in its full efficiency as an economic machine. A tax that takes away a part of the labourer's necessary subsistence, or lowers profits below the minimum for which men will consent to take the risk of investment, is indefensible, and in the long run defeats its own object.

The earliest appearance of this doctrine is with the Physiocrats. Their theory of the '*produit net*' has its chief application in respect of taxation. The fifth of Quesnay's maxims lays down 'that taxation should not be destructive or disproportioned to the sum of the national revenue; that its increase should follow the increase of revenue; that it should be imposed immediately on the *net product* of land.' According to Du Pont de Nemours, 'the portion of the returns called the net product is the sole contributory to taxation, the only one that nature has prepared to meet it. It is of the *essence* of taxation to be a part of the net product of cultivation.' Mercier de la Rivière is, if possible, clearer. 'Taxation is nothing but a part of a net product, and can be levied only on a net product.'[1] The conception of the net product as consisting of nothing but the rent of land appears absurd, but the way in which Quesnay and his followers reached that startling result is not hard to follow. In their opinion the labourer requires a definite amount of commodities for his subsistence; more than that he will not receive, and so much he must get under penalty of starvation. This 'subsistence theory' of wages was fully accepted by the Physiocrats,'[2] and fairly accorded with fact in the France of the *Ancien Régime*. Precisely analogous is the position of the capitalist. The rate of interest is just sufficient to keep up the existing supply of capital. The interest on capital advanced is, Turgot tells us, 'the price and the condition of that advance, without which the

[1] Quesnay in Daire, *Physiocrates*, 83; Du Pont, *ib.* 351; Mercier de la Rivière, *ib.* 474. See also Quesnay's *Œuvres* (ed. Oncken), 332.

[2] The often-quoted passage of Turgot, 'En tout genre de travail il doit arriver et il arrive en effet que le salaire de l'ouvrier se borne à ce qui lui est nécessaire pour lui procurer sa subsistance' (i. 10), shows this.

undertaking could not continue. If that return is diminished the capitalist will withdraw his money, and the undertaking will cease. That return ought then to be sacred and enjoy an entire immunity.'[1]

When wages and profits are removed by the nature of things from the tax-collector's power, it goes without saying that rent is the only remaining source on which he can draw, and we are compelled, their premises being given, to accept the Physiocratic conclusion. Adam Smith, however, declined to follow this seemingly rigorous deduction. He holds that both wages and profits may contribute to taxation, though the amount to be obtained from the former must be very small. Ricardo takes the same view. While asserting formally that it is only from profits and rent 'that any deduction can be made for taxes,' wages 'if moderate constituting always the necessary expenses of production,' he qualifies his statement by the admission that labourers may receive more than their necessary expenses, in which case the surplus is a part of 'net produce.'[2] Finally, J. S. Mill emphasises the share of the labourers in 'net produce,' and seems to desire to amend Ricardo's doctrine on this point.[3]

§ 7. The doctrine of net income as the sole source of taxation, whose history we have just traced, has met with strenuous opposition in Germany. For the last thirty years the fact that taxation is a duty incumbent on the citizen and to be paid by him, not by the pure abstraction called 'net income,' has been loudly proclaimed. Hermann's theory of 'use capital' (*Nutz-capital*) has been employed to show that there is an enjoyment revenue to be added to the economic revenue derived from production in the strict sense. 'It is,' says Cohn, 'undoubtedly income that the owner of a house enjoys from his residence in it, the owner of a park from his enjoyment of the park, that a person enjoys in his own hunting-ground, in his own picture gallery. It is income in the specific form of enjoyment

[1] Turgot, i. 63. [2] *Works*, 210. [3] *Principles*, Bk. i. ch. 11, § 1.

of property.'[1] Such an extension would give a larger fund on which to draw, though it seems preferable to regard these forms of wealth, in the way adopted in a preceding section of the present chapter, as property or capital, and so far liable in exceptional cases to taxation. Of greater force is the argument that the cost of maintaining the State is itself a part of the necessary expenses of the society. The protection of person and property, the duty of the public powers even in the opinion of the extremest individualists, is almost as indispensable as feeding or clothing. So far then from taxation being dependent on the surplus produce of the community, it may with justice be looked on as one of the first charges on the gross production, coming next to that minimum of food and covering that is needed for the preservation of life.

The apparent contradiction between two such plausible opinions can, we believe, be escaped by taking a broader view of the subject than the disputants on either side have done. Necessary expenses are in no case a fixed amount. Each standard demands a certain minimum outlay, but the standard can be varied. The subsistence standard of the English labourer has always been higher than that of the Hindu, and what is true of labour is equally true of the other factors of production. The amount of capital can be reduced to suit a less intensive method of production, and the smaller the quantity needed, the less, *cæteris paribus*, will be the rate of interest. And so is it also with state wants. Their amount and cost can and have to be adjusted to the general position of the society. The difficulty of laying down any definite rule as to the proportion of national income, gross or net, that ought to be devoted to the public service has been shown at an earlier stage of our inquiry.[2] Here it will suffice to distinguish between that part of taxation that conduces directly or indirectly to the production of wealth and that which produces non-economic advantages. The former is beyond dispute a part

[1] § 241.

[2] Bk. i. ch. 8, § 2.

of the cost of production; without it the amount of wealth would be smaller, and the payment of this part cannot be said to come from the net income, or surplus after necessary expenses are met. The latter, like all other forms of enjoyment, can be dispensed with, and yet leave the amount of production as great as before. It may, therefore, be said to come out of the net produce in the wider sense given to the term by Mill. This separation is, however, very hard to carry out. All forms of public expenditure have some effect in promoting industry,[1] and some retrenchment might be made in all without economical loss to the society. Still the principle of the separation is intelligible, and within limits can be usefully employed.[2]

§ 8. Inquiries respecting the derivation of the tax revenue from gross or net income, or from the sum total of the national wealth, may appear at first a piece of unnecessary subtlety. They have, however, important practical bearings. Until the normal source of taxation has been determined, it is impossible to estimate the pressure that it places on a community. The taxable capacity of India or Ireland would be very different according as gross or net revenue is taken as the measure; and in a comparison between Great Britain and the United States, the test of income would probably give the first place to the latter, while that of property would assign it to the former.[3] In another important question of finance the problem of the true source of taxation becomes of moment. The justice of any particular system of taxation cannot be estimated without a knowledge of the fund from which the tax revenue is derived. According as taxation has its source in gross

[1] Cp. Bk. i. ch. 6, § 1, for the relation of state expenditure to industry and commerce.

[2] On the whole question cp. Wagner, ii. 315 sq.; Cohn, §§ 236 sq.; Roscher, § 35; Held, *Einkommensteuer*, 66 sq. For Hermann's theory of income see *Staatswirthschaftliche Untersuchungen* (2nd ed.), 582 598. Professor Marshall has developed Hermann's view, *Principles of Economics*, i. 139 sq.

[3] Giffen, *Growth of Capital*, 124-139.

or in net income our view of the equity of existing systems must vary.

The principles just stated find an important application in the case of the financial position of Ireland. It has been argued with apparent plausibility that the cost of subsistence of the Irish population should be deducted from its gross income in order to ascertain the fund disposable for taxation. But this at once raises the difficult question of calculating the cost of subsistence, and also suggests that the doctrine of section 7 as to the variableness of necessary expenses should be taken into account. Sir R. Giffen has assumed that the amount of £12 per head should be taken as the minimum standard, and thus departs in two respects from the taxation of true net income, for (*a*) the assigned amount is too high for a very poor population, and (*b*) far too low as an allowance for expenditure necessary for efficiency in the higher grades of producers. In comparing the taxable capacity of two countries it is the amount in each really disposable for the tax-collector that should be considered. In no case can this exceed a part of even so-called 'net income.' The poorest population must have something above bare subsistence, since there will always be persons much wealthier than the mass of the people. This question is, moreover, one, not of equity but of fact, to be ascertained by appropriate evidence, which is, in truth, very difficult to procure.[1]

[1] See on this point the *Report* and *Minutes of Evidence* of the Royal Commission on 'Irish Financial Relations' [C. 7720 and 8262]. Special reference may be made to the memorandum of Sir R. Giffen, C. 7720, ii. p. 166, and the note by Prof. Sidgwick, *ib.* 182–3.

CHAPTER III

THE DISTRIBUTION OF TAXATION

§ 1. FROM an examination of the general and what may almost be called the necessary features of the tax system, conditions that are beyond the direct influence of human agency, we have now to pass to a problem of a very different character, viz., the determination of the proper distribution of the burden inevitable in the levy of taxation among the persons or 'subjects' liable to it. Instead of studying 'what is,' we ask 'what ought to be.' The distribution of taxation may be said with far more justice than the distribution of wealth in general to be 'a matter of human institution solely.'[1] Like all questions into which the conception of 'ought' or rightness enters, it is an ethical one; but its correct solution is so bound up with economic and financial considerations that it must remain within the field of financial inquiry. Without a knowledge of the surrounding conditions and the effects of any given tax system, the attempt to form a judgment respecting its justice is hopeless. Moreover, to obtain an approximately correct answer to the question is of great importance to the practical financier. Any error, wilful or otherwise, on the subject is apt to show itself in political difficulties that may in some cases reach an acute point. Nor is it sufficient that a tax system shall be substantially just: it ought to

[1] J. S. Mill, *Principles*, Bk. ii. ch. 1, § 1; cp. Marshall, *Principles of Economics*, Bk. vi. note to ch. 2; also see Nicholson (*Principles*, Bk. ii. ch. 1) for a vigorous criticism of Mill's view.

be generally recognised as such. The prevalence of even an unfounded belief that the public burdens are not fairly divided among the different classes and individual members of a society is a seriously disturbing force. Finance touches on the domain of general politics, and no method of fiscal administration, however successful in other respects, can be worthy of approval unless it seeks, so far as existing conditions allow, to realise the idea of an equitable division of the public charges. The establishment of general principles on this point for the guidance of financial policy and their recognition by the people in general are so eminently desirable, that the investigation of the grounds on which taxation should be distributed is a work of utility in the narrowest practical sense.

The difficulties of the inquiry are increased by several distinct circumstances. First, they are due to the changing nature of the public economy. The city state of Greece or Italy, the mediæval kingdom on a feudal basis, and the nation of modern times have so many points of contrast, their several functions are in outward appearance so different, that it seems impossible to assign a single law of distribution that can include them all and yet be more than a truism. Will it not be necessary to take each stage of political evolution and deal with it separately? Next, even confining our attention to a single type of State, it is not easy to bring the numerous public charges, and the equally numerous functions whose cost they defray, to the test of a common calculation. It is not clear on the surface that all citizens should bear all charges in an equal degree, or that all expenditure should fall on a common and indivisible fund. The text-book writers have, it must be said, created a third difficulty, as they, in too many cases, have supplied us with formulas that allow of a convenient laxity of interpretation, and give an appearance of information without the reality.

Under such circumstances it will be expedient to examine the various rules of distribution, and to note their historical

application. While thus engaged we shall see how misunderstanding has often arisen from neglecting the necessary changes in public economy, and the gradual development of the State, as well as from attempts to stretch a particular rule beyond its legitimate limits.

§ 2. The first and, in one sense, the simplest principle for the distribution of taxation is that which would treat it as a payment for public services. We have already seen reason for rejecting this mode of explaining the nature of taxation,[1] and thereby implicitly its value as a measure of its amount. There was, however, much in the mediæval economic system that tended to foster the belief. Private economies admittedly sold their services, but the royal economy was nothing but the largest of private economies. The King lived by his domain and by the fees that he obtained for the performance of duties. The whole feudal system was based on the idea of contract. Defence against enemies was the payment for the vassal's homage and dues. Justice was bought, and so were the few economic services rendered by the sovereign. Under such conditions the doctrine that taxation should be measured by service supplied was but the formal expression of an existing fact. The growth of the state economy made this no longer true and the doctrine thus became a survival from earlier times. It is still more important to note that the method of specific payment for public services was never a realisation of justice in the distribution of burdens. Neither in respect of national defence nor of legal administration, nor finally of general economic activity, is it possible to distribute the advantages among individuals, and to charge in proportion. The introduction of general taxation was in part a result of the defects of the older mode, and it was undoubtedly a step in advance, particularly in the direction of securing a fairer allocation of the expenses of the public powers. The theory that taxation is the price of the State's services, and finds its measure for each citizen in the amount of benefit

[1] Bk. iii. ch. 1, § 4.

received, is, as regards the latter part, quite unsupported by history. The system of direct purchase applied to the State's tasks was so far from being equitable that justice was only made possible by its abandonment.

Much of the plausibility of this view of the measure of taxation arises from the apparent support that it gives to the individualistic theory of the State. If the services of government are the standard by which to regulate taxation, there appears to be no essential difference between the payment of taxes and the purchase of commodities. The assimilation of the two forms is in reality a forced one. In the case of taxation the advantage given is indefinite, and the payment for it is compulsory; the modern upholders of the doctrine are consequently forced to have recourse to some other standard, which they declare brings about a substantial equality between the benefits received and the taxes paid.[1] That usually suggested is the rule of taxation in proportion to revenue. It is, however, quite impossible to establish any such connexion. Limiting state functions to the minimum, viz. the protection of person and of property, there can be no doubt that the former would in general require equal payment from all. It costs quite as much (if not more) to protect a poor man's person as it does to perform the same service for a rich man. Again, as regards property, there is little ground for the belief that the cost of guarding it varies directly as its value. If security is to be sold like an ordinary commodity, there ought, on the strictest commercial principles, to be some allowance made to the purchaser of a large quantity! The natural conclusion, therefore, appears to be that the rate of taxation should, on the theory of purchase and sale, be lower on large than on small incomes; but even this result does not rest on very solid grounds, since any change in the quantity or quality of state services would alter the relations of the parties concerned.

[1] For a statement of this theory see Thiers, *De la Propriété*, 348, who compares taxation to an insurance premium.

§ 3. The evident weakness of the theory just discussed makes the adoption of some other and more precise criterion necessary. Retaining the idea that taxation should be equal, but giving up as hopeless the attempt to measure the respective services performed for each person by the State, we might conceivably abandon all efforts at differentiation between individuals, and hold that equality was realised by taxing all persons (or all families) at the same rate. Such a method might be admissible in a primitive community. All are dependent on the State for certain essential conditions of social life. Why should not all pay equally for these advantages? Military service is rendered by all alike, and the same principle might seem as applicable to the contribution of commodities as to that of services. Civilised societies have, however, almost forgotten the existence of a state of things in which such an arrangement would be feasible. The annual tax revenue of the United Kingdom may be put roughly at £120,000,000, and the population at 40,000,000. Under a system of equal contribution the rate per head would be £3, or £15 for a family of five. The labourer's family, with a weekly income of £1, would be taxed about 30 per cent.; a middle class family, with £500 per annum, would be taxed 3 per cent.; where the family income was £50,000 per annum the charge would be an insignificant fraction. The method of equal contributions per head would be impossible politically, besides being extremely unjust.

Dismissing then the idea of equal taxation of persons as utterly impracticable, we come to what is the best known and most widely accepted doctrine, viz. that which takes 'faculty' or 'ability' as the measure for taxation. This view, which is found as early as Bodin,[1] has been embodied

[1] 'Sunt igitur ea vectigalia . . . probanda quae in omnes ordines pro singulorum facultatibus exaequantur,' Bodin, *De Rep.* Liv. vi. ch. 2. See Neumann, 'Die Steuer nach Steuerfähigkeit,' in Conrad's *Jahrb.* 1880, for a history of the doctrine. For earlier recognition of the doctrine in England see Cannan, *History of Local Rates*, 17–22, where the phrase *juxta facultates* is quoted from 'Rhymer' as having been used in 1345.

by Adam Smith in the first of his classical maxims: 'The subjects of every State ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities.'[1] For the last thirty years it has been the doctrine accepted by the majority of German writers on finance. One reason for the readiness with which 'ability' has been adopted as the measure of taxation is perhaps its convenient vagueness. The mere statement that taxation should be proportioned to 'ability' does not afford much practical guidance. A measure of 'ability' is further wanted, and in fact different criteria have been put forward with equal sincerity and equal confidence. Property, revenue, net revenue have each been selected as the test of the taxpayer's ability.

§ 4. All the foregoing tests are more or less measurable, and present, so to speak, objective standards, but the measure of 'ability' has sometimes been transformed into that of 'sacrifice,' and this criterion has been widely accepted. 'Equality of taxation,' says Mill, 'as a maxim of politics means equality of sacrifice.'[2] It is apparent that the rule of equality of sacrifice is but another mode of stating the rule of equality as to ability. Equal ability implies equal capacity for bearing sacrifice. An equal charge will impose equal sacrifice on persons of equal 'faculty,' and where abilities are unequal a corresponding inequality in the amount of taxation will realise the aim of equality of sacrifice. There is, however, a shade of difference in the use of the two terms. Ability suggests the positive element of power to contribute, sacrifice the negative one of loss by contribution; the former is most naturally measured by some objective standard, the latter refers primarily to the sentiments of the people concerned, and is, therefore, rather subjective. The use of sacrifice undergone by the payer as the measure of taxation is probably due to a disposition to place weight on the element of

[1] *Wealth of Nations*, 347; cp. 342.
[2] *Principles*, Bk. v. ch. 2, § 2.

privation felt by those who are taxed, instead of on the external marks that indicate ability to pay.

But when the conception of 'sacrifice' is substituted for that of 'ability' the road is opened for a further and more radical alteration. Assuming the utilitarian standard as the true one, it is forcibly argued that the proper distribution of taxation is not that which imposes *equal* sacrifice. The 'greatest happiness' of the society will be best attained by so distributing the burden as to inflict the *least* sacrifice on the whole, and therefore placing the heaviest pressure on those who are far above the average in resources, while exempting altogether those who are much below it.[1] The same train of thought leads to more careful discrimination in the treatment of 'equal sacrifice,' since under this term equal sacrifice in the strict sense and 'proportional sacrifice' are frequently included. Last of all in this process of refinement is the recognition of '*equi-marginal* sacrifice' which will lead to the realisation of 'minimum' or 'least sacrifice.'

These complications in the employment of the sacrifice principle seem to justify adherence to the objective standard of ability, especially as the practical application of the criterion of 'least sacrifice' is impossible.[2] It is clearly inadmissible to use a principle of a highly abstract character, and one limited by other important considerations, as the guide in such an essentially practical study as finance.

§ 5. But whether 'ability' or 'sacrifice' be taken as the standard, it is possible to reach very different practical re-

[1] This view has been specially developed by Professor Edgeworth. See his articles on 'The Pure Theory of Taxation,' *Economic Journal*, vii. 550–566; also x. 174–177, and the summary of his views in *Memoranda on Classification and Incidence*, 127–8.

[2] Professor Edgeworth speaks of 'the enormous interposing chasms which deter practical wisdom from moving directly towards that ideal,' *Economic Journal*, vii. 553. Professor Nicholson recognises that 'the great merit of the faculty theory' is that it is objective. *Principles*, iii. 275.

sults according to the amount of weight assigned to the different elements. We accordingly meet with three different forms of distribution, all avowedly based on the criterion of ability, and all claiming to realise true equality. These are: (1) pure proportional taxation, in which income is taken as the standard, and the amount of public burdens regulated by it; (2) qualified proportional taxation, where income is still the test, but is subjected to certain modifications, either by deduction of necessary expenses or by analysis of its component parts; (3) progressive or graduated taxation, which places a heavier rate of charge on large than on small incomes, since the ability of the 'subject' is supposed to increase in a more rapid ratio than the increase of his income.

The rule of proportional taxation has been undoubtedly the doctrine of the classical political economy. Connected on its political side with the liberalising movements of the eighteenth century, its representatives protested against all exemptions and privileges, and against none more than those granted in respect of taxation. The assertion of the justice of taxing in proportion to revenue carried with it a condemnation of the very common freedom from all personal taxation enjoyed by the privileged classes of the Continent. 'There is,' says Vauban, 'a natural obligation on the subjects of all conditions to contribute in proportion to their revenue or their industry. . . Every privilege that tends to exemption from that contribution is unjust and abusive.'[1] If taxation should be proportional it follows necessarily that it must also be general. The French Revolution, and the changes that it led to elsewhere, so completely abolished the objectionable privileges that this side of the doctrine is often ignored, and its reference to the income possessed alone considered. Adam Smith completes his statement that taxation should be adjusted to the abilities of the subjects by adding 'that is

[1] *Dîme Royale* (ed. Daire), 48; cp. Meyer, *Principien*, § 2.

in proportion to the revenue which they respectively enjoy under the protection of the State.'[1] And since his time the rule has been quoted and adopted by most of his English and French successors.[2] At first put forward as a protest against the injustice of the old system of privilege, the maxim of proportional taxation is now employed as a weapon against the newer Radical socialism.[3]

One great advantage of the rule is its simplicity. As M. Say puts it, 'Proportional taxation does not need definition, it is the rule of three. . . When it is said of a tax that it will be levied proportionally every one understands it.'[4] The problem of taxation is reduced to its least complex form. Given the amount that must be raised by taxation, and given the sum of individual incomes, the rate per cent. can be assigned and applied to each case. It is true that there are certain practical difficulties in the way. The ascertainment of individual incomes is not a perfectly easy work, and where, as is almost universally the case, it is necessary to specialise the tax system and have a number of duly correlated charges, it is difficult to measure the exact amount paid by each citizen to the public treasury. But any other principle must either meet or evade these embarrassments, besides the additional difficulties that are peculiar to itself. Simplicity and easy application, though desirable in finance, are not the sole objects to be attained, and therefore the rule of proportional taxation has been vehemently opposed as failing to give a just distribution of the public charges. The question has, in fact, been mainly debated on the issue whether proportional or progressive taxation should be the system adopted.

§ 6. What is known to Continental writers as progressive[5]

[1] *Wealth of Nations*, 347.

[2] 'Nous l'avons adoptée et nous devons la défendre,' is the expression of Leroy-Beaulieu, i. 139.

[3] See for a full exposition of this point of view Léon Say, *Les Solutions democratiques de la Question des Impôts*. [4] *Ib.* i. 167.

[5] The literature of progressive taxation is an extensive and growing one The most important work in English is Professor Seligman's *Progressive Taxa-*

—but more familiar in England as graduated—taxation includes, as we have said, any system in which the rate of taxation becomes higher, or progresses, as income increases. In this consists the essence of the principle; the grades into which incomes are divided, the initial rate of charge, and the increases at the several stages of advance, though very important, are yet matters of application.

The reasons that have led to the popularity of progressive taxation are obvious enough. The loss of a portion of wealth by a rich man is generally regarded as a very slight evil or as none at all, while to a poor one it causes curtailment of real enjoyment. The deduction of £10 from an income of £100 will in most cases prove a serious pressure, sweeping away perhaps the savings of the period, or compelling the sacrifice of all relaxation; that of £100 from £1,000, though still heavy, would not trench upon the conditions of a comfortable life; £1,000 taken from £10,000 would leave a balance sufficient to support a luxurious existence; and £10,000 from £100,000 would hardly, so popular sentiment imagines, be perceptible by the owner. Yet it is precisely these deductions that proportional taxation carries out, without recognition of the real gradations of ability and capacity for bearing sacrifices. So regarded, the levying of equal rates on all incomes has an appearance of unfairness that has given much support to the plan of graduating charges according to different scales.

Though the general current of economic opinion has till recently been decidedly against the idea of progression, the system has secured the adhesion of some eminent authorities. A passage of Montesquieu's has been often quoted in its favour, in which, speaking of the Athenian property tax, he says, 'it was just though not proportional; if it did not follow the proportion of goods, it followed the proportion of wants.

tion in Theory and Practice, which gives a full account of the chief theories on the subject. Masè-Dari's *L'Imposta Progressiva* is the chief Italian work. Other writers deserving of mention are Neumann, Mazzolo, and Cohen Stuart.

It was thought that each had equal physical necessities, which ought not to be taxed; that what was useful came next, and should be taxed, but not so highly as superfluities.'[1] Rousseau and the elder Mirabeau took the same view. In the nineteenth century J. B. Say and Joseph Garnier approved of a system of moderate progression. The former 'did not fear to declare that progressive taxation was the only equitable form'; the latter held that 'taxation ought to be progressive without spoliation.'[2] Still the weight of authority was on the other side. 'Progressive taxation,' like 'protection' or 'a double standard,' was an heretical tenet opposed to the true economic faith. Alike in England, France, and Germany it was rejected by such representatives of competent opinion as J. S. Mill and McCulloch, Levasseur and De Parieu, Gneist and Hermann.[3]

The recent change in opinion on this subject has been due partly to increased popular influence over government. The shifting in the centre of political gravity that the growth of democracy has brought about has, as one of its consequences, a tendency to alter the distribution of taxation in favour of the most powerful class, *i.e.* the numerical majority. This can only be accomplished by putting a heavier burden on the wealthy. The diffusion of socialistic ideas assists in this movement. Progressive taxation is one of those agencies that seem likely to facilitate the transition from the capitalist to the socialist *régime*, and it consequently has the support of the various sections of that party. Among the counts of the indictment that the French economists bring against the system, one of the weightiest, in their opinion, is its socialistic character.

[1] *Esprit des Lois*, Liv. xiii. ch. 7.

[2] Garnier calls his system 'progressional.' See J. B. Say, *Traité*, Bk. iii. ch. 9; Garnier, *Traité des Finances*, 68.

[3] 'This doctrine seems to me too disputable altogether, and, even if true at all, not true to a sufficient extent to be made the foundation of any rule of taxation.' Mill, *Principles*, Bk. v. ch. 2, § 2. Cp. McCulloch, *Taxation*, 65; De Parieu, i. 38; Levasseur, *Précis*, 343; also Neumann, *Progressive Einkommensteuer*, 112.

Modern developments of economic theory have also had their share in the work. The members of the 'historical' school have not been bound by any undue respect to the opinions of their predecessors, and their greater sympathy with semi-socialist ideas made them inclined to favour what seemed to be a mode of relieving the poorer classes from the pressure of excessive taxation. Accordingly some moderate form of progression has generally received their approval.

Another and apparently opposed school has tended in the same direction. The more accurate study of the variations of utility, which forms the common starting-point of the researches of Jevons, Menger, and Walras, has among its other important effects given a new mode of measuring the pressure of taxation. Final or marginal utility becomes the measure of sacrifice, and if, as is plain, the utility of a shilling is more to the possessor of an income of £100 than it is to one of £1,000, it does not follow that it is exactly ten times as great. The assumption that equal percentages of income are of equal utility is a rough 'first approximation,' admissible, perhaps, in the earlier stages of inquiry, but certain to give place to the more accurate results of later investigation. It is noticeable that Sax and Wieser, who represent the financial studies of the Austrian school, have both declared for progressive taxation.[1]

The substitution of '*least* sacrifice' for '*equal* sacrifice' as the criterion for distributing the burden of taxation would lead of necessity to a more extreme form of progression, approximating to, if not actually attaining, a state of socialistic equality. This substitution is, however, too speculative, and, as previously explained, too much limited by the need of maintaining production, to be seriously considered. Still, even its qualified recognition may be regarded as one of the influences giving support to the movement towards the development of progressive taxes.

[1] Sax, *Staatswirthschaft*, 508-513; Wieser, *Natural Value* (Eng. trans.), 236.

§ 7. A system of progression may be realised in different ways, as by heavy taxes on luxuries consumed by the rich,[1] or by higher duties on the finer kinds of all commodities. Duties on the transfer of property, and on commercial transactions generally, could be so adjusted as to reach the same end, while taxes on inheritance appear to supply a specially effective form of progression.[2] The mode usually employed is, however, that of progressive income and property taxes. This is obviously the most direct way, since it places the increased charges at once on the larger incomes, and has not to trust to the less certain and calculable operation of taxes on 'consumption' or on 'acts.' In form the tax may be on property, or on income, or on both; but as in any case it must normally be paid out of income, the assessment of property is simply a particular mode of fixing the rate of charge.

But whatever be the form adopted, the policy of progressive taxation is open to serious objections, of which the following may be noticed as the most important.

In the first place, it is entirely arbitrary. The possible scales are infinite in number, and no simple and intelligible reason can be assigned for the selection of one in preference to its competitors. The schemes proposed vary widely. Some are of a very drastic character, aiming in fact at confiscation of all income above a certain appointed level.[3] Others are more moderate, and seek only to realise a supposed equality of sacrifice, or simply to somewhat favour the poor as against the rich. But the fact that such divergent plans can be plausibly propounded is highly significant.

[1] The English assessed taxes might have been thus employed.

[2] Professor Seligman, *Progressive Taxation*, 212–215; West, *The Inheritance Tax*. See Bk. iv. ch. 9.

[3] Amongst specimens of this class the plan of the late F. W. Newman, by which the tax rate increased 1 per cent. with each additional £1,000 of income, may be mentioned. A common formula is that 'the tax should triple as the income doubles, the starting point being selected according to the propounder's fancy. But there is evidently no limit to the varieties of arrangement.

Actual examples of progression, as we shall see, are not of an extreme type. The highest rate of charge is fixed at a comparatively low percentage. It still remains true that there is no self-acting principle by which to determine the scale of progression. We must perforce agree with Léon Say's declaration that 'progression is naturally arbitrary.[1] Opponents of the system will hold that the mildest form is the least objectionable, and try to attain that result (unless they prefer to have an extreme measure in the hope that its hardships may cause a reaction). Reasonable supporters will recognise that a rapidly increasing rate is both unjust and economically injurious. But beyond such vague propositions nothing can be stated. All depends on the will of the legislature, *i.e.* in most modern societies on the votes of persons who will not directly feel the charges placed on the higher incomes, and will probably believe that they will be gainers by them.[2]

[1] *Impôts Démocratiques*, i. 172. It may be suggested that the scale that would give the maximum revenue should be chosen, but this is (*a*) extremely difficult to determine, and (*b*) is not consistent with the aim of proportional sacrifice. It is besides quite possible that several different scales would satisfy the condition.

[2] The objection to progressive taxation on the ground of its arbitrary nature has been a leading point with French economists, *e.g.* Leroy-Beaulieu, i. 148, and was emphasised by the older English school, but is treated as of slight importance by most recent writers. Prof. Seligman declares that 'all governmental actions which have to do with money relations of classes are necessarily more or less arbitrary . . . . a strict proportional tax . . . . is really more arbitrary . . . . than a moderately progressive tax. The ostensible "certainty" involves a really greater arbitrariness.' *Progressive Taxation*, 194. Mr. Devas, while allowing the objection where the aim 'is not to equalise sacrifice but to equalise property,' regards it as inapplicable to 'moderate graduation.' *Political Economy*, 529. Prof. Nicholson holds that the 'objection is purely formal. It is equally applicable to the relative proportion of direct and indirect taxes.' *Principles*, iii. 278. In reply it may be remarked that though it is true that all action of a sovereign government is in a sense arbitrary, the adoption of a definite principle based on 'simple and obvious' grounds limits the capricious exercise of the power. Such a limiting principle exists in the case of proportional, but is absent in that of progressive, taxation. The distribution between direct and indirect taxation is regulated by reference to the effect on the different classes concerned, and, though unavoidably imperfect, ought to be directed by a general rule. But in any case the adoption of progression brings in an *additional* element of arbitrariness in the selection

Another serious obstacle to a progressive system is the danger of evasion. No empirical law is better established in finance than that which states that high taxation leads to efforts to avoid it. Duties on luxuries are in part escaped by the smuggler's aid; special duties on the better kinds of goods lead to false declarations; graduated inheritance taxes are met by concealment and gifts *inter vivos;* progressive income and property taxes cause false returns on the part of the contributors. For this latter fact there are several reasons. The increased charge on higher incomes offers a special inducement to understatement on the part of those liable, as thereby they obtain the advantage of a lower rate, a proceeding the more readily excused to their consciences by the plea that the exaction escaped is itself unjust. Another reason is the impossibility of employing effective measures for collection. With a uniform income tax a great deal of income can be taken at its source, where evasion is impossible; with progression, as the rate varies according to the sum of income, the ascertainment of that fact is required for fixing the charge, though it is undoubtedly very difficult to get a proper answer to inquiries respecting it. Thus the motives for evasion are stronger and the means of prevention less effective in the case of a progressive than of a proportional tax.[1] It is the intrusion

of the particular scale, which may be compared with the additional uncertainty in a double standard currency owing to the possible varieties of the ratio between the two metals. The appeal to the analogy of judicial decisions suggests the difference between the settled rule of 'law' and the fluctuating judgments of 'equity.' As Selden could truly say that 'equity is a roguish thing,' so can it be said that the policy of progressive taxation, particularly in a democratic society, is an uncertain thing.

[1] Prof. Nicholson, in questioning the force of this objection, seems to have misconceived its real bearing. 'Though the personal method of declaration must be applied to the surplus, it will still be as effective as in other cases, and the chance of evasion may be allowed for.' *Principles*, iii. 278. But the essential point is that the introduction of progression necessitates the adoption of the comparatively ineffective method of personal declaration for all income, and thereby increases the opportunity, as the higher rate stimulates the desire, for evasion, which no doubt must 'be allowed for' in estimating the yield of the tax, just as the encouragement to smuggling must be considered in the case

of the personal and arbitrary element that raises this difficulty, which is accordingly unavoidable.

A third powerful argument against progressive taxation is derived from its probable effect on the accumulation of wealth. One of the motives to providence is the desire of gaining a large fortune, but a system that in its extreme forms prevents, and in any case hinders, the attainment of this desire must, it is argued, check the growth of capital. The imposition of special taxation on the larger incomes or properties is, in fact, a fine on saving, and consequently an impediment to the supply of one of the auxiliaries of production. If the legislator is to interfere at all, he ought rather to encourage the formation of new stores of wealth that will, in the vast majority of cases, be used to assist industry.

The discouragement to the growth of capital may operate in two different ways. There will naturally be a movement of wealthy persons from a district in which they are subjected to special penalties. Any existing outflow of wealth will be increased, and the influx of other wealth so far checked. Such is a very probable and serious danger in a small district from which movement is easy, and with the modern tendency to international movements of capital it may occur even in large areas. But for countries with a highly developed system of industries, another effect is more to be dreaded, viz. the stoppage of saving at an earlier period. Capital may not emigrate readily from such a country as England or France, but the annual increment may become smaller and finally cease. Considering the dependence of industry on the facilities for obtaining new capital, it would seem that any artificial check to its growth would be a grave evil and likely to react on the finances of the State.

of heavy duties on luxuries. The need for making this allowance is generally regarded as weighing against such duties, and similar reasoning in respect to progressive taxes seems warranted. The experience of Italy with its income tax gives support to the belief that reliance on declarations of income is unsatisfactory.

In mitigation it may be urged that progressive taxation is not in fact likely to weaken the disposition to save. It will only affect those who possess a good deal already, and such persons save as much from habit as from conscious motive. There is, too, the further fact that the heavier taxation on the rich will leave the poor a larger disposable sum, part of which they may save, and to that extent increase the store of wealth. But though in both those ways the loss to capital under a moderate progression may be reduced, it seems clear that some loss there will inevitably be, and it is incumbent on the supporters of any measure tending in this direction to show what compensation will be gained through fairer distribution.[1]

In discussing this matter it is well to remember that the productiveness of a progressive tax on incomes is not as great as is popularly supposed. This failure to reach expectation is due partly to the evasions that have been noticed as incident to the tax, and also to the various devices, not absolutely illegal, that are used to escape the extra pressure. If rigorously collected the tax causes much capital to emigrate; discretion is therefore very often employed in enforcing claims, and in either case the revenue suffers. Another reason is found in the fact that in most countries large incomes do not form a large proportion of national revenue. Taxation to be productive

[1] This objection is regarded by some writers as applicable 'to the whole system of taxation on property or income' (Seligman, *Progressive Taxation*, 195), or to 'all taxes on capital' (Nicholson, *Principles*, iii. 278), and therefore 'not applicable to progressive taxation as such' (Seligman, *loc. cit.*). This view, however, does not take into account the extra pressure on the growth of accumulation that a progressive rate must cause. The case is similar to that of increasing fines for each repetition of an offence, the wrongdoing consisting in the saving or production of a given amount of wealth. As stated in the text, there may be some compensation in the effects of moderate progression, but this gives no support to Professor Seligman's courageous assertion that 'If a moderate progressive tax is really more equitable than a strictly proportional tax, progression will be less of a fine on thrift and industry than proportion would be' (*loc. cit.*). The usual arguments against progressive taxation are given in Lecky's *Democracy and Liberty*, ch. 3, in an old-fashioned form and with no consideration of recent theoretical discussion.

must draw on the resources of the middle and working classes. The unproductiveness of progressive direct taxes is paralleled by the small yield of taxes on the luxuries of the rich as compared with duties on articles of general consumption.[1] To obtain the funds needed by the State pressure must be placed on all classes of society, not merely on the prosperous.[2]

§ 8. The foregoing objections, which may be distinguished in their order as political, moral, and economical, are so weighty that a very clear proof of injustice inflicted by any other system than progression must be made out in order to sanction its use. The injustice of proportional or regressive taxation, if established, would tend to show that for the realisation of equity progression in some form must be adopted. But in support of this contention we have nothing except the appeal to equality of sacrifice as the standard, and the alleged failure to conform to it by taking equal proportions from different incomes. The deduction of £10 from A's income of £100 and of £10,000 from B's of £100,000 will, it is maintained, inflict greater suffering on A than on B. Such is the assumption of the upholders of progression, and their view accords with popular sentiment. There is, nevertheless, room for doubt. Is it really certain that A, whose income is reduced from £100 to £90, is worse treated than B, whose £100,000 is brought down to £90,000? There can be no dispute as to the wants which the latter will have to leave unsatisfied being very much slighter than those of A, when looked at from the same point of view.

[1] Cp. *Wealth of Nations*, 375.

[2] As pointed out by Professor Seligman and Nicholson, the slight increase in return obtained by progressive taxation is not an *objection* to its use. It can at most be regarded as showing that its advantage must be looked for else where. 'If it is conceded that the progressive tax is more equitable than the proportional tax, it is utterly immaterial whether it yields more revenue or not.' Seligman, *Progressive Taxation*, 195. In deference to this criticism, the text of earlier editions has been altered. It is nevertheless true that as a great engine of fiscal reform progressive taxation is in Proudhon's words 'un bilboquet, un joujou démocratique,' which will not relieve the poorer tax-payers.

But the point of view is not the same. B's system of life on its material side is so differently constituted from A's that any comparison of the kind is absurd.[1] £10 from A's income may mean the loss of a certain amount of alcoholic drink; B, by having to give up £10,000, may lose the chance of purchasing an estate, or may have to abandon some social scheme that he could otherwise have carried out. The economic calculus is not at present competent to deal with such comparisons. The complexity of the problem is admittedly great, and not to be solved by simple methods.[2] The weightiest difficulty that the theoretical advocates of progression have to meet is the essentially subjective nature of their standard. Its translation into an objective rule of taxation can be accomplished only by the aid of assumptions as to the relations of enjoyment in different classes that must contain a large element of conjecture. The modern elements of the theory of utility fail to supply any definite practical basis on which to frame a scale of progression.

Progressive taxation has been supported by a very different line of reasoning in Cohn's brilliant *Finanzwissenschaft*.[3] Proportional taxation is asserted by him to be the logical result of the 'contract' or assurance theory of the State. In accordance with that belief, it was fitting that all should pay the same proportion of income in exchange for the stipulated services. The modern or 'higher' conception of the State abandons altogether this theory of the social compact, and therefore its corollaries, in which is included the rule of proportional taxation. Writers who like Rau, De Parieu, and Leroy-Beaulieu reject the older view of the

[1] See Wicksteed, *Alphabet of Economic Science*, for a clear statement of the general principle applied in the text. Signor M. Pantaleoni argues that the richer person (B) may even suffer more (1) if the additional wealth happens to be of special importance to him, or (2) if his sensibility be keener.

[2] Cp. Sax, 'Die Progression ist keine vollständig regelmässige. Je nach der Beschaffenheit der einzelnen Bedürfnissgruppen kann sie bald geringer sein, vielleicht zum Stillstand gelangend, bald in raschen Sprüngen emporsteigen. *Staatwirthschaft*, 512.

[3] §§ 210, 211.

State's relation to its subjects, and yet maintain the justice of proportional taxation, are guilty of inconsistency, explicable only by their dread of the often-described evils of progressive taxation.

To this ingenious contention the answer is that, granting the derivation of the rule of proportional taxation from the 'assurance theory,' the refutation of the latter does not upset the former, since a true conclusion may result from false premises. But even this concession need not be made. It has been argued in the present chapter that the exploded doctrine of 'assurance' would logically lead not to proportional, but to what has been called 'regressive' taxation, *i.e.* to a lower percentage on large than on small incomes.

§ 9. Experience of the actual working of progressive systems might be expected to throw light on the reality of the evils attributed to them and their real operation. A large amount of evidence has been collected with this object by very competent inquirers,[2] but, unfortunately, the results are not decisive. Most of the cases discussed are those of Swiss cantons or the smaller German States. (The short-lived income-tax of the United States and the progressive income-tax of Prussia are the chief exceptions.) Now, the financial arrangements of small political bodies are undoubtedly full of instruction and deserve attentive study, but they belong to the domain of local rather than general finance. The conditions of working are therefore different, and there is to some extent room for the use of a different principle of distribution,[3] since the public services rendered by local bodies do often allow of an estimation of their value to individuals, and, besides, have to be considered in connexion with the taxation of the State.

The peculiar economic conditions under which progres-

[1] The *progression à rebours* of French economists.

[2] Neumann, *Progressive Einkommensteuer, passim;* Léon Say, *Les Impôts Démocratiques*, i. 203–258; ii. 225–264; Leroy-Beaulieu, i. 152–156, 160–168; Cohn, §§ 213, 214; Palgrave, 'Progressive Taxation in Switzerland,' *Journal of the Statistical Society*, ii. 225–267; Seligman, *Progressive Taxation*, Part I.

[3] See § 13; also ch. 6 of the present book, 'Principles of Local Taxation.'

sive taxes have been applied are clearly shown in the discussions respecting their operation, which are chiefly concerned with the danger of forcing capital to emigrate and that of undue discrimination against particular persons. Both are real and serious in a small area; within the wider boundaries of a nation their probability would be smaller. It is hardly conceivable that the English Chancellor of the Exchequer should arrange his scheme of taxation with reference to any small number even of the wealthiest taxpayers; nor would the emigration of capital be caused by even a fairly heavy tax. On the other hand, the facilities for assessment are much increased by having to deal with a limited district in which the income and property of each resident can be ascertained with a close approach to the truth, and as incomes are in no case very large, there is not the same room for injustice. Progressive taxation could not be easily applied in national finance. The forms of wealth are very numerous, and can be so placed as to escape the tax-collector's notice when he has to deal directly with income as a whole. We have, therefore, no evidence sufficient to modify the unfavourable conclusion reached on general grounds respecting progressive taxation.[1]

§ 10. The idea of securing equality of sacrifice while escaping the dangers of unregulated progression has led to the adoption of what is known as 'degressive' taxation, a system in which a uniform rate of tax is levied beyond a prescribed limit; but incomes under that limit are either altogether exempt, or rated only for a part of their amount. Some of the so-called progressive taxes in Switzerland are really of this kind. Thus in Zürich 500 francs are free, the excess up to 1,500 francs is rated at only one-fifth, the next 1,500 francs at two-fifths, the next 3,000 at three-fifths, and the next 4,000 at four-fifths, anything beyond being rated at its full amount, *e.g.* an income of 12,500 francs (£500)

[1] Particular instances of progressive taxes will be considered in Bk. iv. chs. 4 and 9, 'Taxes on Property and Income,' and 'Taxes on Successions.'

would only pay on 8,300 francs.[1] By this method the confiscation of the higher portions of income can never happen, but there is still an arbitrary power of fixing the several scales which is inconvenient, while this form of progression is particularly open to the charge of unproductiveness, and is somewhat hard to work owing to the minute subdivisions that are usually made.

Degressive taxation may, however, like the more moderate forms of progression, be employed rather to secure than to destroy proportionality of taxation, as it affects only one part of the tax-system, and may correct inequalities in other directions. When the articles consumed by the poorer classes are heavily taxed, they would contribute more than their share to the maintenance of the State were they not relieved through the income and property taxes. This is one of the reasons for the exemption of incomes of £160 and under from income tax in the United Kingdom and the abatements on those up to £700. The duties on tea, sugar, tobacco, spirits, and corn, which chiefly affect the smaller incomes, are thus balanced, and a substantial equality (or what is believed to be such) attained. The rule of proportionality is applicable only to the whole tax-system, and it may be necessary to have several partial inequalities in order to establish that final equality which is one of the principal merits of a financial system.

§ 11. Another ground for modifying the rule of proportional taxation exists in the doctrine that net income is the sole available fund for social objects. If certain kinds of expense be necessary and unavoidable, it seems that any income which only suffices for meeting them should be exempt from taxation. On the supposition that the labourer's wages are just enough to keep him alive, the

[1] *I.e.*

500	Free	0
1,000	$\frac{1}{5}$	200
1,500	$\frac{2}{5}$	600
3,000	$\frac{3}{5}$	1,800
4,000	$\frac{4}{5}$	3,200

slightest extra charge will lead to his death, unless he is relieved from some other quarter. Taxation on the minimum of subsistence must, by the nature of the case, be paid by somebody else. The Physiocrats, as we saw,[1] extended this argument to the interest on capital, but their successors have not accepted this extreme view. However, the doctrine known as 'the exemption of the minimum of subsistence' is widely spread. Among its supporters in one form or other may be reckoned Justi, Sonnenfels, Bentham, Sismondi, Hermann, and J. S. Mill, and it long received recognition in the English system of taxation, in the avoidance of duties on the necessaries of life, while, as just mentioned, incomes up to £160 per annum are free from direct taxation.[2] The different interpretations put on the doctrine need to be distinguished. The primitive and most natural meaning is that which limits it to the absolute necessaries of existence, though here there is room for doubt as to the correctness of including the expense of maintaining a family under this head. The wider use of the term to cover 'the sum of the means of support which, according to the standard of a given period, is required for the conduct of an existence worthy of man,'[3] would extend the exemption far beyond the limit of physical necessaries, and would almost reach to the exclusion of whatever expenditure is necessary for the earning of the person's income from the amount to be taxed.[4] By regarding the outlay requisite for the support of each grade of income and its expenses of pro-

[1] Bk. iii. ch. 2, § 6.

[2] The effect of local rates and the shifting of taxation do in fact put some of the pressure on the very poor, but the statement in the text is true of the immediate effect of imperial taxation up to the recent changes by which sugar and imported corn have been put under taxation.

[3] Schmidt, *Steuerfreiheit des Existenzminimums*, 4, 5.

[4] The criterion of 'necessaries' varies according to the class concerned. 'We may say that the income of any class in the ranks of industry is below its *necessary* level when any increase in their income would, in the course of time, produce a more than proportionate increase in their efficiency.' Marshall, *Principles of Economics* (3rd ed.), i. 139.

duction, we might bring the fund available for taxation down to a very small amount.

Such a construction of the doctrine may be dismissed as impracticable. The subject's outlay is determined by himself and is directed for his own advantage. The only ground for doubt would be the possibility of expenditure on these 'necessary' items being curtailed in consequence of the tax. This effect would be very improbable unless the rate of taxation were so heavy as to show bad administration, but even in the limited case of physical necessaries the argument for remission is not so clear as might be thought. The danger of relieving the lowest class of labourers from nearly all the burdens of the State while it holds preponderating political power is apparent. Again, there is much force in the view that public expenses are a part of necessary expenditure. 'The State,' argues Cohn, 'belongs as much to the life of every civilised man as his daily food or the air; without the State a civilised existence is not thinkable. The minimum of every moral existence includes the blessings of the State. It follows that the minimum of outlay for existence must also include the necessary expense of the State.'[1] Why should not the poorest citizen pay something towards security as well as purchase the bread that supports him? The practical side of the question seems rather to favour the English policy of the later years of the nineteenth century. So far as the argument from ability is concerned, it is plain that those who barely possess the means of subsistence have little or no ability to contribute. In any country where legal provision is made for poor relief it would seem that to tax those at the point of minimum subsistence would be simply to drive them into the ranks of pauperism, and to take with one hand in order to give back with the other. The

[1] In *Political Science Quarterly*, iv. 64–5. Cp. 'Der Staat ist für alle ein Bedürfniss, seine Existenz ist für die Gesammtheit nothwendiger als das Leben eines Einzelnen.' Held, *Einkommensteuer*, 103.

cost and trouble of raising money by direct taxation from the poorer classes, added to the foregoing considerations, strongly supports the method of exemption from direct taxation of the smaller incomes with the employment of moderate taxes on the luxuries of the poor.[1] When exemption is claimed for the minimum it can only be on the ground that it will be employed in buying necessaries; any other application of this amount fairly brings it under the weight of taxation.[2]

§ 12. The question of justice may also be raised in respect of incomes that differ not in amount but in origin. As usually debated, the point is confined to the case of an income tax, but it is really wider, and applies to all forms of taxation. To put the issue in the simplest way, let us suppose that of two persons one, A, obtains by his exertions £500 per annum; the other, B, obtains the same sum from the rent of land or from interest on capital. Is it just or expedient that A should pay the same sum in taxes that B does? The most natural answer is a negative one, and many persons have proposed that the capital values of the two incomes should be taken as the basis of taxation.[3] A little reflection will, however, show that under certain conditions there is nothing unjust in the arrangement. A's income, it is true, is less durable, but so is its chance of taxation. The permanence of B's receipts involves likewise permanence of taxation. So long then as the public charges are uniform, there is no reason for complaint. Special occasions will sometimes occur in which extra-

[1] Mill's view on the subject, though his conclusion is the same as that in the text, appears to be inconsistent with his views on population and his criticism of allotments (*Principles*, Bk. ii. ch. 12, § 4). Would not taxation of the minimum tend to check population, and exemption tend to increase it?

[2] The doctrine of the exemption of the subsistence minimum received a new application in the discussions on Irish taxation. The error pointed out in the text was adopted by Mr. Sexton in his report, and countenanced by Sir R. Giffen. See *The Final Report* [C. 8262], 70–1. Cp. Book iii. ch. 2, § 8, and *infra*, § 15.

[3] See the reports and evidence of the Parliamentary Committees on the Income Tax 1852-53 and 1861, especially the evidence of Newmarch, Farr, and J. S. Mill.

ordinary expenditure actually is, or is deemed to be, necessary, and then it seems that as there is an extraordinary call it ought to come from the capital rather than from the income of the community. A convenient mode of realising this end would be the imposition of an additional property tax, which, being met out of the income of the holders, would accomplish the end of taxing permanent incomes at a higher rate.[1] Another mode would be to meet the increased outlay by loans to be repaid in a series of years.

In practice the difficulty is not so great; the distribution of burdens can never be accomplished with mathematical precision. The avoidance of real and serious grievances is all that can be expected, and the actual working of the financial system meets these in a tolerably satisfactory manner. Necessity compels recourse to loans whenever there is any large extraordinary outlay, and thus the particular holders of incomes from labour are in fact relieved. Again, the two categories are not so sharply divided as is supposed; they shade into each other at many points; and, moreover, the return on property (as distinct from 'unearned increment') is itself the result of saving, and entitled to as liberal treatment as any other form of revenue. The technical difficulties that surround any attempts to differentiate incomes belong to a later part of our inquiry.[2]

The foregoing considerations are helpful in considering a very different proposal, also aiming at a departure from the rule of taxation in proportion to income, viz. that which asserts that expenditure alone should be taxed, savings being entirely exempt. The reasons given in support of this privilege are (1) that saving is not enjoyment, but a useful social process that deserves encouragement; and (2) that savings, unless exempted, would pay twice over, viz. first at their origin, and again when they yield a further return after investment. It may be freely allowed that to

[1] See the proposal of Mr. Blunden for a tax on the yield of property (*i.e.* in fact, a differential income tax). *Economic Journal*, vii. 607 sq.

[2] Bk. iv. ch. 4, 'Taxes on Property and Income.'

encourage providence is desirable, but it does not follow that exemption from taxation is the proper mode for so doing. If income be the normal fund from which taxation comes, and if it is on its amount that the measurement of the burden is to be taken, an arbitrary separation of a certain part is obviously objectionable. The line between saving and expenditure is besides a thin one; the true distinction should rather be between productive and unproductive expenditure, *i.e.* the result of outlay ought to be the test, a plainly impossible course in practice. Further, it may be said that many forms of productive outlay are just as enjoyable as any non-productive one, and some forms of the latter are socially preferable to others. There is, in reality, no reason for a sharp division into two classes, whether we take enjoyment or social advantage as the basis. Practical finance could not deal with such shades of difference as would be the apparently fair course. The same consideration may be applied to the case of temporary and durable incomes, the former of which are very variable in character.

To the plea of double taxation it may be replied that taxation is imposed on income as such, that the wealth which is taxed as income is not identical with the extra produce that is the result of its application, and the charge on each is distinct. The income out of which savings are made cannot be the same as the subsequent income produced by those savings.[1]

There is, it should also be noticed, a direct opposition between the proposal to relieve temporary incomes and that to exempt savings from taxation. What is the balance of advantage in getting a premium to save, only to discover that the earnings which result from that saving will be subject to heavier payments? The broad and simple principle of taxing all incomes alike, and of taxing all that is income (allowance being made for the action of taxes on consumption in the case of the smaller incomes), appears to

[1] See Vocke, *Abgaben*, 471–2.

attain the result of just distribution quite as well as the more refined discriminations so often suggested. Should any further adjustment seem necessary in a particular system, it may be reached by a nominal property tax,[1] or by duties on inheritance.

§ 13. The principal theories and contentions on the subject of the just division of taxation have now been considered, and it remains to state the general results which seem to be warranted. The attempt to measure taxation by the amount of service rendered has been recognised as hopeless and due to an erroneous theory of the State's nature, but it contains a small element of truth. Where specific and measurable advantages are rendered to individuals or groups, direct payment for those services ought to be obtained, either in the course of exchange or by the payment of fees, or, if neither method can be employed, by a special tax. Cases of the latter are very rare in general, but they hold a more prominent place in local finance. Indeed, as we shall see, the division between local and general taxation is itself a case of making those interested pay for special services, and in the detailed division of local charges the same principle can often be applied.

The use of 'ability' or 'faculty' as a measure of taxation is encumbered by the necessity of defining its true meaning. We have seen reason, chiefly on practical grounds, for rejecting the interpretation which issues in the system of 'progressive' taxation. Its fiscal productiveness is slight, while its economical effects are likely to be injurious. Between the system of payment as recompense for state services, which would naturally lead to regressive taxation, and the system of progression, resting on the idea that sacrifice should be equalised, the intermediate method of taxation in proportion to income is on the whole the best standard for regulation. Its true foundation needs to be carefully appreciated. It cannot claim to be a realisation

[1] *I.e.* a tax assessed on amount of property, but really paid out of income.

of exact distributive justice; it is rather to be accepted as a convenient and fairly definite working rule of finance, or at the utmost as supplying a measure of what may be called the objective side of ability. Income, when the lower grades are passed, is, we may hold, a fairly good mark of power to contribute, provided we make abstraction of individual circumstances.

In the same spirit we can solve the problem raised by the existence of incomes at the minimum. Financial convenience combines with economic conditions to make it desirable to exempt the smaller revenues from direct taxation where the duties on articles of common consumption are productive. Where it is possible to relieve necessaries from taxation, the minimum of existence is in fact free; where the needs of the Exchequer prevent this being done, the pressure placed on the lowest class is of a kind not much felt by them unless the rate of taxation is excessive. To tax the very poorest is a sad necessity, but where the want of revenue is urgent, not inconsistent with justice; there is a real advance when national wealth has reached so high a point that the lowest class are called on to contribute only through their luxuries, but the highest stage is that in which the improvement of society is such that all classes are in a position to pay their share as citizens for the common services of the State.

Thus it appears that the distinction between temporary and permanent incomes, as also that between expenditure and savings, may, speaking generally, be disregarded in practice as involving subtleties unsuitable for fruitful application and to a great extent cancelling each other, and the result is that on the whole, and speaking broadly, taxation should be proportioned to revenue, by which a fair approximation to justice and a convenient basis of working are supplied.

§ 14. One class of revenue is so peculiarly situated that its position deserves special notice, viz. that which arises from 'unearned increment' in the widest sense of the term,

including the growth of rent from land, monopoly profits, and the gains of speculation.[1] The characteristics of this class seem to have marked it out as peculiarly suited for taxation. The physiocratic tax on land was not, indeed, due to this idea of it as yielding a monopoly gain, but the practical result was just what it would have been in that case. Adam Smith distinctly notes the fitness of unearned gains for special taxation. 'Ground rents and the ordinary rent of land are,' he holds, 'perhaps the species of revenue which can best bear to have a peculiar tax imposed upon them. . . . . Nothing can be more reasonable than that a fund which owes its existence to the good government of the State should be taxed peculiarly,'[2] while later on he widens his view by declaring that 'the gains of monopolists, whenever they can be come at,' are 'certainly of all subjects the most proper' for taxation, a doctrine the truth of which as a general statement can hardly be denied. Regarded by itself, unearned wealth seems, as it were, designated to supply the public wants of the community,[3] and there is no reason for surprise at the popularity of any proposals in that direction. But the imposition of taxation must be studied not simply with regard to a single general fact, but to the whole economic and financial constitution of the society. The obstacles in the way of this form of special taxation are serious enough. To begin with, it is not always easy to say what gains are 'unearned.' The rent of land and the receipts from pure speculation are the first examples, but the line that separates pure rent from profit rent is not so readily determined. As Adam Smith remarks in this connexion, 'The ordinary rent of land is, in many cases, owing partly at least to the attention and good management of the landlord.'[4] In a new country the gain

[1] All included in the German '*Conjuncturgewinn*.' Cp. Professor Marshall's explanation of '*Conjunctur*,' *Principles of Economics*, i. 656.

[2] *Wealth of Nations*, 356, 378.

[3] For a forcible statement of this view see George, *Social Problems*, 205–208.

[4] *Wealth of Nations*, 356.

from land is profit rather than rent,[1] and as society advances the investment of capital in land improvements complicates the problem. In the case of commercial speculation it is not pure accident that determines gain. Speculation is rather, as Cohn well describes it, the struggle of intelligence against chance.[2] To tax the profits of speculation would check the operation of the economising force of competition. Monopoly gains are better fitted for extra burdens, and where excessive profit is obtained, through natural or legal monopoly, there is good reason for obtaining at least some of the advantage for the public. But these cases are so few as to form but a trivial financial resource. Railways, banks, and some other companies are the principal examples of possible monopoly, and among them the amount of excessive profit is not considerable. Two further circumstances diminish still more the importance of this extra source of tax revenue, viz. (1) the existence of losses that counterbalance unearned gains. If individuals engage in a venture, be it cultivation of land or industrial enterprise, they can hardly be called on to give up their surplus gains unless they are guaranteed against possible loss. A landholder will not care to develop his property with the certainty before him that his accruing 'producer's surplus' will be appropriated by the State, while he has no security for ordinary interest on his outlay. The same feeling will be even stronger in industry and commerce than in agriculture. Just as weighty is (2) the fact that with a system of private ownership and a developed economic organisation the titles to these 'unearned gains' are in a constant process of transfer, and future values are estimated in the prices given.

[1] Cp. Sumner, *Life of Jackson*, 184–5; Marshall, *Principles*, 486–7.

[2] 'Die Speculation ist nicht bloss, wie Lassalle behauptet, "ein Rathen auf die Wirkungen, welche die unwissbaren Umstände hervorbringen werden." Sie ist mehr als das. Sie ist der Kampf der mit Kenntniss der wissbaren Umstände ausgerüsteten Intelligenz gegen die rohe Uebermacht des Zufalls.' Cohn, § 343. On the important functions of speculation in the modern economic system see Hadley, *Economics*, ch. iv., and the fuller discussion in Emery, *Speculation on the Stock and Produce Exchanges of the U.S.*

The anticipated future movement of rent is registered in the price of land. Premiums on shares measure the gain from speculation or monopoly. Justice could therefore be attained only by taxing each increase immediately on its existence being noticed, an evidently hopeless endeavour. For these reasons it is desirable to narrowly limit special taxation of monopoly values to the clearest and best established cases, and for the rest to rely on the increased productiveness that this unearned wealth will give to the ordinary taxes. This conclusion, it may be added, does not apply to any existing land taxes, which may be plausibly regarded as reserved rents, nor does it cover the specially interesting case of ground rents in towns, where the effect of public expenditure introduces a new and difficult element, and one which strictly belongs to the domain of local finance.[1]

§ 15. So far we have dealt with taxation as if it were applied to a single country or district in a state of complete isolation, and have sought to discover the just distribution of the burden between the inhabitants. This is, indeed, the most important part of the equities of taxation. But its examination does not exhaust the area of inquiry. Some interesting and difficult questions remain for discussion. One, which has lately attracted much notice, is the proper division of taxation between the several parts of a common realm. To put the issue interrogatively: Is there a rule of just distribution between districts or countries similar to that between individuals, and, if so, what is its nature? It is necessary in order to obtain a satisfactory basis for discussion to begin by distinguishing the different cases. Taking first the loosest form of connexion we find two, or more, countries under a common ruler, but with independent governments and distinct financial systems, and having to make provision for certain common expenses. Here it is hardly possible to lay down any general rule. The comparative benefit of a particular

[1] For state ownership of land see Bk. ii. ch. 2, § 4. On the Land Tax, see Bk. iv. ch. 1; and for taxation of ground rents ch. 6, § 5 of the present Book.

service to the countries appears the fairest standard, but this, owing to the great difficulty of estimating it, is generally replaced by some test of presumed service or comparative ability, no very clear separation being made between the two bases. Thus the diplomatic and consular services of Sweden and Norway have been met by joint contribution. The relation of the United Kingdom to India has led to more elaborate treatment of some joint services and a good deal of debate as to the justice of the particular arrangements.[1] Political convenience and the spirit of compromise are the really controlling forces in such a situation.

The second class of cases is that in which a distinct financial system is formed to meet those expenses that are regarded as 'common,' the necessary revenue being obtained by contributions from the divisions in some settled proportion. The determination of the proportion necessarily raises the question of the proper rule to be applied, and the disputes as to the principle of benefit against that of capacity or ability are sure to make their appearance. In the most prominent actual examples a rough empirical rule has been employed. 'The value of all land within each State . . . as such land and the buildings and improvements thereon shall be estimated,' was the standard in the United States under the 'Articles of Confederation.'[2] The respective quotas of Austria and Hungary by the compact of 1867 were 70 per cent. and 30 per cent. That any crude arrangement of the kind can realise justice is almost impossible. There is no single criterion of ability and no definite measure of proportional advantage. As Alexander Hamilton declared, 'The attempt to regulate the contributions of the members of a confederacy by any such rule cannot fail to be productive of glaring inequality and extreme oppres-

[1] See the *Reports* of the Commission on 'Indian Expenditure' [C. 8258. 9; Cd. 130. 131] especially iv. 90–127 (ch. 3 of *Final Report*) for an examination of the heads of outlay where joint contribution was suggested. The governing principle propounded was that of 'common interest,' which apparently means 'common benefit.'

[2] Article 8.

sion.[1] The most feasible course in the face of this difficulty is to provide for an automatic re-adjustment, based on the chief elements of 'advantage' and 'capacity' to take place at definite periods. It may, indeed, be said that the relation is too unsatisfactory to be durable unless in a very exceptional situation.[2]

In a true federal union the conditions of the problem are altered. Instead of an arrangement between separate political units there is a system of taxation operating on persons, natural or juristic, and enforced by sovereign authority. The question of equity is then reduced to the problem which has occupied the preceding sections of this chapter, viz., the just division of the charge amongst the 'subjects' of the tax-system. Nevertheless there may be room for complaint on the special ground that the actual taxes press unfairly on some districts as compared with others. In a federal union indirect taxation is allotted to the national government, 'State' governments being confined to direct taxes. By this division, which has undoubted advantages,[3] the central government has the opportunity if so disposed of burdening some States to the advantage of others.[4] Constitutional provisions are some slight safeguard, but, as in other cases, they prove to be inconvenient and not always effective.[5]

[1] *The Federalist* (Letter 21) 123 (Lodge's edition).

[2] The financial weakness of the 'Confederation' was one great reason or the adoption of the present Constitution of the United States. 'Finance was the great overwhelming trouble which laid bare the fatal vices of our political system, and it was on financial rocks that the rickety Confederation was dashing itself to pieces.' H. C. Lodge, *Alexander Hamilton*, 39. The peculiar condition of the Austro-Hungarian Empire accounts for the retention of the present system.

[3] See *infra*, Bk. iii. ch. 6, § 3.

[4] The history of the United States, Switzerland, and Germany supplies instances. Hamilton admits the difficulty but seeks to extenuate it. 'Imposts, excises, and, in general, all duties upon articles of consumption may be compared to a fluid which will, in time, find its level with the means of paying them.' *Federalist*, 124. The whole paragraph is worth reading as an early example of the equal diffusion theory. Cp. Seligman, *Incidence*, 133–4.

[5] The provision in the United States' Constitution respecting direct taxes was designed for this purpose. It has had the serious effect of preventing the establishment of an income tax.

The unitary state ought, it would at first sight appear, to be free from any complication of the kind, but when several countries have been united into a single State the question of just distribution between those countries may be raised. A remarkable example is that of the United Kingdom. By the Acts of Union, Scotland (1707) and Ireland (1801) were combined in a legislative unity. From the first the excise and customs were applied to the whole of Great Britain, the land tax alone being arranged on a proportion. In the earlier years of the Irish union, in consequence of the large amount of the debt of Great Britain, separate Exchequers were retained and the unsatisfactory plan of quotas was adopted, the Irish contribution being two to the British fifteen. Owing to the real Irish contribution falling short of this proportion—it only amounted to 'one' out of 'thirteen'—the Irish debt was so much increased that consolidation of the Exchequers became possible, and was carried out in 1817. One limiting principle was enacted in the Act of Union—that no higher tax should be imposed on an article in Ireland than in Great Britain, and for many years higher duties were levied in the latter country. Substantial equality of rates was not, in fact, reached till 1858.[1] Since then there has been equal taxation of persons similarly situated in any part of the United Kingdom.

This, however, it has been argued, does not secure true equality. Though the rates of taxation are the same, the practical result is to impose on Ireland a charge, excessive as compared with her 'resources' or 'taxable capacity.' Deducting subsistence, which should be untaxed, the available surplus is small and is kept down by oppressive taxation imposed in contravention of the pledges given at the passage of the Act of Union.[2]

[1] The Income tax reimposed in England in 1842 was not extended to Ireland till 1853. The Irish spirit duties were equalised only in 1858.

[2] See the Report of the Commission on Irish Financial Relations, especially the memoranda and evidence of Sir R. Giffen and Mr. M. O'Brien. For a more extreme view see Lough, *England's Wealth, Ireland's Poverty.*

To this case the usual reply has been that under a common system of taxation the question of justice is one between *persons*, not between *countries*. If the several individuals are fairly treated the aggregates composed of them can suffer no injustice.[1] The general principle that all taxation must fall on persons[2] gives force to this plea. There are, however, some considerations in qualification of this generally sound principle. Taxation may be equal as between persons of the same class, but very unequal as between those in different classes. A large use of indirect taxes will press severely on the poorer classes of society: the income and inheritance taxes will fall chiefly on the rich. It can hardly be denied that duties on tea, sugar, spirits, and corn would be more felt by the Irish population than an equivalent increase of the income tax. Again, the articles selected for taxation may be those principally consumed in one country, while their substitutes in other countries may be free or lightly taxed. Further the tax system may injuriously affect the production of one country while sparing that of another. It is true that a well organised financial system will avoid these evils, which result from non-observance of established principles, but the fact that they come out prominently in the case of a country may lead to their speedier detection. It must also be remembered that two countries may not be suited for a common financial system. Difference of habits and institutions may be so great as to render it impracticable. On the other hand there can be no doubt that where it is possible fiscal union is an enormous benefit, and substantial unity of taxation, when once attained, is too great an advantage to be lightly surrendered. Attempts to prove inequality of taxation on the ground of supposed inferior taxable capacity rest on too indefinite a basis to be safely applied in practice.[3]

[1] This was the position occupied by Mr. Gladstone, Sir S. Northcote and English finance ministers generally in dealing with this question.

[2] Bk. iii. ch. 1, § 3.

[3] Cp. the several estimates made for the 'Financial Relations' Commission.

Should it appear that one territorial part of a State is overtaxed the true remedy is a reform of the tax system; this course will have the additional merit of relieving those who are suffering in like manner in the other divisions, while not affecting those in the particular area who are not really injured. It besides keeps closely to the rule of dealing with persons as the real tax subjects.

§ 16. Another important class of problems is that connected with international taxation. The conception of a country or even a group of countries as isolated or self-contained is far from according with the actual conditions that prevail in any modern society. Owing to the development of trade and of international relations generally, the residents in a country have varied economical ties with other lands. Many of them draw part of their revenue from abroad and are interested in foreign industrial and commercial undertakings. Increasing liberality in bestowing the privilege of naturalisation and the reduction of aliens' disabilities encourage foreigners to hold property, and thus bring themselves within reach of the taxing power of the State. This steady growth of international dependence gives much greater importance than formerly to the difficult problem of double taxation, and makes it essential to consider the chief cases coming under that title. But in so doing we need not enter into the imposition by a State of different taxes on the same object, nor into the apparent double taxation of persons. Whatever be the proper rule of distribution, any kinds of taxation, however complicated, which conform to it are justifiable. Thus the corporation tax—now being developed in the American States—is seen on analysis to be in reality taxation of the shareholders in the corporation, and is therefore to be counted in estimating the total burden on them.[1]

Also Sidgwick's 'Note,' *ib.* ii. 182; see in addition, *Economic Journal*, vi. 189–94, and Béla Foldes, *Finanz-Archiv*, xvii. 798–9.

[1] For scientific discussions of this question see Adams, *Science of Finance*, 449–64; Seligman, *Essays*, ch. 8. The great development of industrial companies in America, and the peculiar restrictions of the federal constitution

Exclusion of the cases of apparent double taxation leaves a clear road for the examination of international as distinct from domestic taxation, or—to put the distinction more accurately—the conflict between different tax jurisdictions. One instance may be easily disposed of, viz. that in which a citizen removes himself and his property from one country to another. Here the country that he leaves has no right, and in fact no power, to exact contributions from him. He belongs altogether to the country of his adoption. More difficult in practice is the case in which the owner of property resides abroad and draws his revenue for use in the country in which he dwells. Here it may be asked, how shall the charges of the two States be distributed in an equitable manner, or what guiding principle should be employed? On the old protection or assurance theory, it would follow that the country of residence should be paid for protecting the person, and that where the property lies for guarding it; but as this doctrine is now exploded, we must look elsewhere for an answer. It would seem reasonable that special taxes on property or local rates should be assigned to the country of situation, while the general income tax and indirect taxes on commodities consumed by the person would accrue to the country of residence. But this course is not free from difficulties. In the first place, it is by no means easy to draw a clear line between the general income tax and the special produce taxes. Then, certain forms of income derived from abroad, *e.g.* rent of land, may claim exemption. A still greater difficulty is found in the attempt to deal with those diverse forms of immaterial property which pass so often from hand to hand. The foreign stockholder and still more the foreign company give rise to almost insoluble puzzles.[1] Finally the treatment of wealth passing at death when the

have given the corporation tax prominence which it has not received elsewhere. The formation of international trusts and combines will probably increase its importance in European finance.

[1] Interstate taxation of companies in America and the income derived from colonial investments by residents in England may be referred to in illustration.

deceased possesses property in two or more countries requires careful consideration.[1] One broad principle—that of reciprocity—might seem to afford a satisfactory solution, but where the countries are very differently situated even this method fails. Taxation of colonial property when held by residents in the United Kingdom would not be counterbalanced by similar taxation of British property owned by residents in Australia. It becomes necessary to obtain fairness as well as nominal equality, and this can only be reached by international agreement.[2] In a federal State such problems should, it seems, be decided by the central authority, or by constitutional provisions. In the analogous case of local taxation, another method—the separation and limitation of the forms of revenue used for local purposes—is advisable.[3]

§ 17. Our judgment as to the equity of any particular distribution of the pressure of taxation will depend on the view that we take of the results to be attained. Even when taxation is limited to the supply of the public wants the proper division of its weight may vary according to the amount and character of the services supplied by its employment. Where state functions are confined to the narrowest possible field, the poorer classes may claim to bear a smaller share than if—as in many modern societies—they were largely benefited by public expenditure. But from the difficulty of discrimination it seems better to adhere to the general rule of distributing taxation without direct

[1] The discussions on the Finance Act of 1894 respecting the levying of the estate duty on property simultaneously taxed in the Australian colonies supplies a good illustration.

[2] It should be noticed that the introduction of progression into the tax-system tends to increase the difficulties connected with double taxation, as in the case mentioned in the preceding note.

[3] See Bk. iii. ch. 6, §§ 3,4, and on the whole subject of 'double taxation' cp. Cohn, §§ 223–228, Roscher, § 63, Wagner, ii. 406 sq. Recent contributions to the subject are Seligman, *Essays*, 95–120; Walker, *Double Taxation in the United States;* Westlake, *Economic Journal*, ix. 365–374; Flora, *Le Finanze degli Stati Composti;* A. Garelli, *Diritto Internazionale Tributario.* Prof. Westlake's article is the first indication of study of the subject in England.

reference to the results of expenditure on the different classes. Injustice of this kind ought to be corrected, not by redistribution of taxation, but by alteration of outlay.

There is a tendency in recent years to take a wider view of the functions of taxation than the purely financial one. Its agency is regarded as valuable, not solely for the resources that it brings into the State, but for the effect that it produces on the distribution of wealth. By the use of a properly adjusted tax-system the inequalities of wealth may, it is thought, be reduced, if not entirely removed, and one of the aims of Socialism approached without revolution. Such is Wagner's position when he declares for the 'politico-social' conception of taxation in opposition to the 'pure financial' one. This change in standpoint must of necessity change the mode of estimating the justice of taxation. What is wise and prudent when we aim simply at supplying the requirements of the public powers in the fairest and cheapest way ceases to be such when it is sought to bring about a supposed better distribution of wealth. Proportional taxation, caution in taxing unearned wealth, and moderation in expenditure may be admitted to be the logical results of the 'financial' conception: progressive taxation with a high rate of increase, rigorous fiscal supervision of all gains except those from labour, and bold attempts at improving the condition of the poorer classes by state outlay in various directions will be the natural outcome of the 'social' attitude.[1] The change of aim necessitates a corresponding change in the methods adopted.

The general arguments on the subject of socialistic interference do not concern us here, but the results of financial experience are of some value in respect to the use of taxation for other than fiscal purposes. The taxing power has been often employed to encourage industry,

[1] See Wagner, i. 47, 500; ii. 381 sq. 455-459, for a statement of the 'social' view.

to improve taste, to benefit health, or to elevate morals, but in none of these applications has the desired success been obtained. There is, therefore, a strong presumption against its use as an agent for remedying the inequalities of wealth. Its definite and universally recognised function is the supply of adequate funds for the public services. To mix up with one very important object another different and perhaps incompatible one is to run the risk of failing in both. It is within the power of financial skill to so select the forms and rates of taxation as to secure the requisite amount without unfair pressure on any class, but if the ulterior effects on the distribution of wealth have to be considered, and adjustments made to attain particular ends in that respect, the difficulties of the task are enormously increased. If the socialistic *régime* is the goal to be sought, there are more direct and more effective modes open than the manipulation of taxation.[1]

§ 18. At the opposite pole to the doctrine that finance should aim not solely at preserving justice, but at remedying injustices already existing in the social system, is that which refuses to see anything of justice in financial problems.[2] For the upholders of this view the distribution of taxation is reduced to placing the burden where it will give the least trouble and friction in collection. McCulloch's often-quoted statement that 'the characteristic of the best tax is not that it is most nearly proportioned to the means of individuals, but that it is easily assessed and collected, and is at the same time most conducive to the public interests,'[3] is a sufficiently clear expression of the view which is a very natural feeling among practical adminis-

[1] Cp. Prof. Nicholson's judgment on 'the social function of taxation.' *Principles*, iii. 282-4.

[2] And yet this doctrine has a curious affinity to that of minimum sacrifice. See *supra*, § 4.

[3] *Taxation and Funding*, 18. Cp. 'The problem which every Chancellor of the Exchequer professes to solve is not how to levy taxes in proportion to capacity to bear them, but how to get the money he requires with a minimum of suffering and discomfort to the nation.' Cannan, *Economic Review*, vii. 111.

trators. An escape from the difficult questions that the problem of justice must always present is a pleasing prospect, though unfortunately based on illusion, since injustice in distribution is certain sooner or later to show itself in the very difficulties that the practical financier wishes to avoid. All the conditions of a good system of taxation are interdependent, and the breach of one reacts on the others.[1] The observance of the mere technical rules at the expense of justice will not be successful, any more than the utmost straining after fairness without regard to the other conditions which we proceed to examine in the next chapter.

[1] This is, of course, not inconsistent with the doctrine that 'economy' is of even more importance than 'equity,' which is so vigorously expounded by Mr. Cannan (*Economic Journal*, 469-80). Cp. Bk. iii. ch. 7, §§ 5, 6.

CHAPTER IV

THE TAX SYSTEM: ITS FORMS

§ 1. THE construction of a system of taxation, like all works of art, is the result of a combination of materials derived from different quarters. To attain success it is necessary to bear in mind certain general facts respecting the economic structure of society; the important aim of realising substantial justice in the apportionment of burdens must never be lost sight of, and in addition the technical and financial conditions require to be duly considered. It is to this latter class of problems that the present chapter will be devoted, and we shall see what form the tax system ought to take in order to satisfy these various requirements and be at the same time effective for what is after all its primary function—the supply of adequate resources for the public service.

The facts of past and existing financial institutions, when compared with the general principles discussed in the preceding chapters, present at first sight a curious contradiction. Taxation, we discovered, was normally a deduction from the national income, and ought to be divided among the citizens in proportion to the share of that income possessed by each. Though some qualifications of this statement were made,[1] such was the broad general result: from which it would seem to follow that the amount needed should be levied from the taxpayer in a single

[1] See Bk. iii. ch. 2, §§ 6-7; ch. 3, §§ 11-12.

payment in proportion to his ascertained income. In fact, the single tax would, we might think, be the necessary deduction from established principles.

On turning to the facts of practical finance the state of things is very different. No country possesses this simple and logical arrangement. Instead of a single tax we find a considerable number of imposts varying according to place and time, and very hard to reduce to any reasonable classification. Taxes on every form of production, on nearly every commodity, and on most of the transactions of life, may be found in the history or statistics of finance.

One partial explanation is that which attributes the complexity of the public charges to ignorance or love of routine on the part of practical financiers. The beginning of the tax system, obscured as it was by the other forms of state receipts, was due to fiscal necessity. Extraordinary levies were made by the sovereign on the wealth most easily reached and owned by the feeblest members of the community. 'To raise the largest sum of money with the least trouble'[1] is an inadequate description of the functions of a modern finance minister, but it was the chief aim of his mediæval predecessor.[2] It may then be thought that the immediate pressure of the public wants has been the cause of the undue complication in the methods of taxation.

Such, however, is not the case. There is no doubt an element of truth in the assertion that it was want of funds that led to the creation of so many different forms of taxation. A war period is usually a time of financial pressure, and most new taxes owe their introduction to occasions of this kind.[3] But when the pressure is removed and the work of financial reform made possible, though great consolidations of duties are effected, there is no example of recourse to

[1] A dictum credited to Sir G. C. Lewis.

[2] The need for drastic fiscal expedients was greater in mediæval times than it is now, and this explains much of the seeming harshness of the earlier regal policy.

[3] The war period (1793-1815) affords a good illustration of the disposition to impose fresh taxes, Dowell, ii. 208-245; cp. also the recent sugar, coal, and corn duties.

that simple method that appears so natural and appropriate in the light of some elementary principles. It is, therefore, necessary to examine the grounds on which a multiple system of taxation is retained, notwithstanding the apparent advantages of the single tax system.

§ 2. In the face of the general, indeed universal, policy of employing diverse forms of taxation, there has been at times a strong disposition on the part of students of finance to propose some particular kind of impost that should tend to supersede all others and be the principal resource of the Exchequer. Prominent amongst such plans is that promulgated by the famous engineer Vauban in his *Dîme Royale*. He does not, as has been sometimes supposed, advocate the complete abolition of all other charges. Among the duties to be retained were a moderate salt duty, the customs, and some of the taxes on acts: but the *taille*, the capitation, the *aides* (internal duties chiefly on drinks), the provincial customs, and the miscellaneous sources of revenue classed as 'extraordinary' were to give place to a single tax—the 'Royal tithe'—imposed on the product of land, industry, and, in short, all revenue, its amount to be five per cent. or ten per cent. according to necessity.[1] His contemporary Boisguillebert, with whom he had so close an intellectual affinity, put forward the same idea of a single tax of one-tenth of the product of land and industry.

A similar tendency is shown in Sir M. Decker's plan[2] (referred to and criticised by Adam Smith) of a licence for the consumption of luxuries as a substitute for the excise and customs, a scheme which, in spite of its obvious difficulties, has been reproduced in a modified form in later

[1] Vauban, *Dîme Royale*, 50–98. A remarkable proposal was placed before the States-General of 1577 at Blois. Besides the duties whose repeal was advocated by Vauban, the salt tax and the customs on wine were to be removed, and a graduated duty on households, called *taille égalée*, was to be employed. Clamageran, ii. 217–219.

[2] It is doubtful whether this plan should not be really ascribed to Richardson. That was McCulloch's opinion. See Seligman, *Incidence*, 57 n 1; also Professor Gonner's article on 'Decker' in Palgrave's *Dictionary of Political Economy*.

times.[1] The popularity of duties on consumption favoured the growth of plans like this. Still more significant was Vanderlint's scheme for a single tax on land and its products, perhaps suggested by some remarks of Locke. The pamphlet in which Vanderlint stated his plan is a distinct anticipation of the physiocratic idea as to the true system of taxation.[2]

§ 3. The proposals already described came from individual thinkers, and had little or no influence on competent opinion or on financial practice. But in the circle of economists who regarded Quesnay as their master the dogma of a single tax—the *Impôt unique*—became an accepted article of belief. This doctrine was the natural result of their theory as to the limits of net produce. The rent of land was, they thought, the only 'source' of taxation, and it was therefore convenient that it should be its only 'object.' Vauban's idea of a Royal tithe was good so far as simplicity went, but it was unequal,[3] inasmuch as it fell on capital employed in cultivation, which, in the physiocratic dialect, was not 'disposable.' In the application of their principles the Physiocrats were more inclined than is sometimes believed to admit modifications. The elder Mirabeau was prepared to raise two-thirds of the requisite revenue by an income tax, leaving only one-third for the land tax, and Turgot frankly concedes that the time had not come for an abolition of *octrois*.[4]

Besides the plan of a single tax on land rent, which has recently received support on different grounds from that of

[1] For Adam Smith's criticism see *Wealth of Nations*, 371. The idea of a general consumption tax was propounded by Revans, *A Percentage Tax on Domestic Expenditure*, and by Pfeiffer, *Staatseinnahmen*, ii. 538–554.

[2] Vanderlint's *Money answers all Things* appeared in 1734. See Ricca Salerno, *Dottrine Finanziarie in Inghilterra*, 23–26.

[3] See Turgot's advocacy of the single tax on land. He declares: "Cette proposition est contraire à l'opinion de ceux qui avaient conçu le système de la dîme royale. . . . Ce système peut effectivement éblouir par sa simplicité, par la facilité du recouvrement, par l'apparence de la justice distributive. . . . Il pêche cependant par différents inconvénients," i. 404.

[4] Mirabeau, *Théorie de l'Impôt*, 316; Turgot, ii. 114.

its originators, other forms of single taxation have been suggested in the nineteenth century. One is the general income tax, which would directly attack the normal source of taxation, and secure whatever distribution seemed desirable to the legislator. In the form suggested by some economists it would be proportional to receipts, and might be so framed as to cover acquisitions by gift or inheritance.[1] Radical democrats would prefer that the single tax on incomes should be more or less rapidly progressive.

The plan of a single tax on 'realised property' has also received much support. It would be confined to property not engaged in production, 'as land, the public funds, money lent on mortgage, and shares . . . . in joint-stock companies,'[2] and was believed by its advocates to escape the inequalities of the income tax, and to present greater facilities for collection, since the objects of assessment would be definite and open to observation.

Of rather wider scope is the plan for a single tax on capital, put forward by De Girardin and Menier, and approved by M. Guyot. Under it taxation is to be imposed on 'fixed' capital—*i.e.* on 'all such utilities as yield their products without changing their nature,' to wit, 'land, mines, buildings, machinery, implements, ships, carriages, animals employed productively, furniture, and works of art.'[3] Raw materials and goods for sale would be exempt from charge. The basis of assessment proposed is the selling value of the taxable capital, one per cent. of which would, it was believed by Menier, be sufficient in the case of France to meet the public expenditure.

§ 4. These several plans have certain elements in common, and appeal to the very natural desire to secure a simple and inexpensive form of taxation. Were there no obstacles in

[1] An ingenious plan of this kind was proposed by the late W. N. Hancock. See his *General Principles of Taxation as illustrating the advantages of a perfect Income Tax.*

[2] Mill, *Principles*, Bk. v. ch. 2, § 3.

[3] Guyot, *L'Impôt sur le Revenu*, 222. See also Menier's various works, especially his *L'Avenir Économique.*

the way, it is plain that direct imposition on the source of taxation would be preferable to the complicated methods actually employed. The cost of collection would be materially diminished, and the immediate incidence on the several individuals and classes precisely determined. Moreover, the community, as distinct from the State, would gain by the removal of restraints on industry, and it could measure definitely the cost of the public services.

Against such plain and obvious advantages there are weighty considerations to be set, which militate against the adoption of a single tax in any form. (1) The danger of a single tax, no matter how skilfully estimated, not being duly proportioned to revenue is a serious one to which any other proposed base, *e.g.* capital or expenditure, is equally open. With a combination of different taxes the errors in any one case will be small, and probably compensated by the operation of other taxes, but with a single tax there is no possible room for correction. Experience shows that what is in appearance a perfectly fair tax may be practically very unequal in its operation. Evasions and false returns may destroy the proportionality of the best arranged income tax. (2) The pressure of taxation in most modern States is by no means a slight one. On the average it exceeds ten per cent. of the national revenue. Now it is evident that 'the ignorant impatience of taxation' would prevent this amount being raised without much irritation through any single tax. To disguise the burden is, so far as sacrifice is concerned, to reduce it, and the breaking up of the system into several distinct forms undoubtedly has this advantage. (3) The use of a single tax would remove the advantage that is obtained at present by reaching the different forms of taxable capacity. Consumption, income as returned or assessed, property inherited, are all so many indications of the capacity arising from the possession of revenue, which, when duly considered, enable a better proportional rate of taxation to be maintained. Besides, in certain cases it is, as we saw, necessary to separate the tax-payer's contribu-

tions, and treat some as given for special service, or to assign the total amount between different countries and districts. A single tax would fail altogether in this respect. (4) It is, moreover, important to note that a so-called single tax is not necessarily a simple one. Thus a general income tax is often a combination of several special taxes, and may often prove just as troublesome and complex. A tax on fixed capital would be in fact a tax on land, mines, factories, furniture, works of art, &c., which would be so many separate categories for distinct assessment. A general tax on consumption or expenditure would be even more involved. The simplicity of such plans is therefore often only apparent, and covers a real complexity. (5) The results of the shifting of taxation increase the force of the preceding argument. A proportional tax in assessment may in the ultimate incidence be a very one-sided charge. Taxation in the simplest shape introduces a complicating element into the economic system, the effects of which are hard to follow and often very far removed from what first appearances would suggest.

§ 5. The foregoing considerations and actual fiscal practice have given countenance to the directly opposite doctrine, which has been perhaps most precisely enunciated by Arthur Young. 'The mere circumstance of taxes being very numerous, in order to raise a given sum, is a considerable step towards equality in the burden falling on the people; if I were to define a good system of taxation, it should be that of bearing lightly on an infinite number of points, heavily on none. In other words, that simplicity in taxation is the greatest additional weight that can be given to taxes, and ought in every country to be most sedulously avoided.'[1] This passage has at least the merit of placing the issue in a clear and definite form. To attain equality in distribution there ought on this theory to be an almost

[1] *Political Arithmetic.* A statement quoted with approval by Sir G. Lewis Northcote, *Financial Policy*, 309. Mr. B. Holland has recently sought to revive it, *Economic Journal*, vii. 219–20. As shown in the text, it has no support either from theory or experience; see *Economic Journal*, vii. 420–22.

universal system of taxation touching the people at every point. Property, income, consumption, transactions, inheritance should all be moderately taxed in order to make the burden as even and as light as possible. Young's views were, beyond question, produced by repulsion from those of the Physiocrats, and went even farther in the opposite extreme, but they do not inaccurately describe the characteristic feature of the finance of the eighteenth century. As a standard for modern times they are evidently inapplicable and opposed to the most important and valuable reforms of the nineteenth century. To secure the placing of pressure 'on an infinite number of points' would require the interference of the revenue authorities in most of the industrial processes and the private life of the community. Taxes on all commodities, on transfers of goods, and on the different forms of production would be extremely prejudicial to the development of industry, irksome and inconvenient to the payers, and very costly in collection. Financial history affords abundant examples of these evils. The *Alcavala*, a duty levied on all sales, has been regarded by Adam Smith as the cause of the ruin of agriculture and manufactures in Spain.[1] The English customs before the first reforms of Huskisson exemplified the evils of undue multiplicity in one branch of taxation, and the United States revenue system during the Civil War was an even more striking instance of the same defect.[2] To properly arrange and combine a great number of duties is too difficult a task to impose on administrators, who are sure, even with the utmost care, to inflict much injustice and cause heavy losses.

§ 6. The defects of the opposed systems of single and of multiple taxation tend to countenance what may be called 'plural taxation,' in which the revenue is not on the one hand collected by a single form of duty, nor, on the other,

[1] *Wealth of Nations*, 381.

[2] For the English tariff, Dowell, ii. 249-261; Buxton, *Finance and Politics*, i. 18, 19. For the United States, Wells in *Cobden Club Essays* (2nd series), 479.

divided into a great number of trifling charges. Under the existing conditions of society this is the course that has most in its favour as being at once most productive, least inconvenient, and on the whole approaching nearest to justice. But it is necessary to remark that this conclusion is limited to present circumstances. It does not follow that it may not be possible at some future time to adopt a single tax system, or at least a very close approach to it. Among the arguments urged against the single tax is that of the actual weight of taxation and the risk of exciting discontent by raising the required sum in a single payment. Suppose, however, that public expenditure were greatly reduced, so that, instead of eight, ten, or fifteen per cent. of national revenue, only three or four per cent. were required; it might well be that the relief to industry and the facility of collection would make an income tax advisable as the sole agent for raising revenue. So large a reduction of expenditure is hardly to be expected. When dealing with that part of our subject we saw that the tendency was towards increase, but it is not difficult to conceive how a very different state of things might have come into being. Let us suppose that England had never engaged in the Revolutionary and Napoleonic wars, and that her foreign policy had been for the past century that of rigid 'non-intervention.' Were such the case the financial results would certainly be (1) the entire absence of the national debt with its charge of £23,000,000 and whatever surplus may actually exist; and (2) the reduction of the army and navy estimates to probably one-quarter of their normal figure. Moderate reductions in the Civil Service would allow of further curtailment of expenditure, with the result that not more than in round numbers £25,000,000 would have to be provided by taxation. An income tax of 8*d.* in the pound (including as it should the smaller incomes now exempt) would be the most direct mode of procuring that sum. The position of the United States, if the Civil War had been obviated by prudent statesmanship, would be even

more favourable. A very moderate income tax would have met all the expenditure of the years 1850–1860, as the low customs duties actually did.[1]

It thus appears that the form of taxation depends in a great degree on the amount of expenditure. With moderation in outlay it is possible to have simplicity in taxation, and the difficulties of the problem of expenditure, already hard enough, are increased by the need of weighing the greater difficulties of heavy taxation. It is eminently true that wise policy is essential for sound finance.[2]

§ 7. Financial pressure makes the retention of different forms of taxation, if not an absolute necessity, at all events highly advisable in the interests both of the State and of the payers. And this being so, we have next to examine the comparative merits of the different forms in use. The first broad distinction—that between direct and indirect taxes—has some connexion with the controversy as to single against multiple taxation. The most popular forms of the single tax are direct, while most of the charges in a multiple system are indirect. There has been accordingly a not unnatural tendency to confuse two separate issues by identifying singlewith direct and multiple with indirect taxation. This confusion is increased by the fact that the great advocates of the single land tax laid particular stress on its being direct. 'The essential form of taxation,' says De La Rivière, 'consists in taking taxation *directly* where it is, and not wishing to take it where it is not. . . . To change that *direct* form of taxation in order to give it an *indirect* one is to reverse a natural order from which we cannot depart without the greatest inconvenience.'[3] The idea that taxation should not lead to shifting and repercussion was one of the strong points of his school. The original conception of direct taxation as being that which is imposed immediately on the

[1] Cp. Leroy-Beaulieu, i. 179–185.

[2] Cp. the well-known saying of Baron Louis, 'Faites-moi de bonne politique et je vous ferai de bonnes finances.'

[3] *Physiocraets*, 474. The italics are in the original.

ultimate source from which it comes was, as we saw, altered for administrative convenience, and applied to cases where recurring payments were made and lists of tax-payers kept.[1] But this use of the term, whatever its technical advantages, obscures the broad line of division that the older meaning gave, and which really possesses so much scientific importance. Whether a duty is assessed directly on the ultimate bearer or is passed through various intermediaries before reaching him, may not be capable of being precisely determined in all cases. There are no hard and fast lines in fact, and the instances on the margin may be numerous, but if we take the terms, not as giving a complete classification of taxes, but as marking the presence or absence of a certain characteristic, they may be employed with advantage, but rather to suggest reasons for discrimination than to definitely settle results.[2]

The expressions 'direct' and 'indirect' have received a further alteration which makes it more difficult to employ them without careful explanation. Taxes on property and income form a very large part of the direct taxes; those on commodities, collected from the producer or dealer, an equally large part of the indirect ones. These are, besides, the special forms of the two kinds of taxation that are usually selected as types in discussions about them, so that it is not difficult to understand how the comparisons between direct and indirect taxation have become for the most part an inquiry into the relative merits of taxes on income and property as against taxes on commodities.[3]

[1] See Bk. iii. ch. i. § 8.

[2] 'The classification of taxes as direct and indirect, it may be as well to premise, has been objected to on the ground that it cannot be consistently applied. . . . But this objection applies only to the wording of the ordinary definition of direct and indirect taxes, and we may safely continue to employ the terms to denote the radical distinction intended; namely between taxes on the one hand levied either directly from the contributors themselves or from funds on the way to them, and taxes on the other hand on producers or dealers, in the intention that they shall recover them in the prices finally paid by consumers,' Cliffe Leslie, in *Cobden Club Essays* (2nd series), 192.

[3] See for further discussion Prof. Bullock's article already referred to (Book iii. ch. i. 1, § 8). He supports the treatment in the text.

This employment of the terms is supported by the distinct origin of the two forms. 'Taxes' on property and persons (*Steuern*) present a marked contrast to the 'duties' on goods and commerce (*Abgaben und Auflagen*), in the fact that the former were direct, the latter indirect. A feeling of this original separation is at the root of much of the discussions on the merits of the two classes, and helps to make the issue more obscure.[1]

Still, the contrasts between the two groups of taxes that are usually regarded as being direct and indirect, quite apart from the question of incidence, has a sufficient value to make it convenient in estimating the merits of a given system. The peculiarities of the separate taxes that a more scientific arrangement exhibits may fitly be treated in dealing with particular taxation, but the broad general separation that is so familiar in financial discussion serves better for the purpose of showing the requisite conditions of taxation as a whole.

§ 8. Starting, then, with the conception of direct taxes as those levied immediately on the 'subjects,' or ultimate bearers of the charge, and therefore embracing taxes on income and property, or on their component parts, in opposition to duties on commodities and on exchange, where there is a shifting of the burden from the immediate payer to the 'subject' which justifies the name of 'indirect,' we have to consider the merits and defects of each class, and the most desirable mode of combining them.

At the outset the advantages of direct taxation seem to predominate. As income is the ultimate source of taxation, its immediate imposition is the most obvious and rational way of claiming a share in the produce for the State. The taxes on the different components of income have the same merit. Rent, interest, and earnings are the natural objects on which to place the charges of the State. Where it is thought desirable on grounds of justice to tax property, the direct mode of doing so seems the simplest and least involved. As a single tax appears better than a multiple

[1] See Dowell, *Hist. of Taxation*, Pref. xii.; Vocke, *Abgaben*, 1–16.

system, so does direct taxation seem superior to indirect, and for much the same reasons. There is the greater facility and lower cost of collection, and the power of knowing the exact amount paid by each person liable. The drawbacks are also of the same kind. The greater dislike to direct levies of taxation is notorious ; the demand for payment is more disagreeable than the fact of paying, as it brings home the existence of the charge without any possibility of escaping notice. Formerly financiers were too anxious to avert popular resentment to have recourse to this form, unless in extremities, and in modern days taxation must be suited to the taste of the voters. Another difficulty is the necessity of assessment in all direct taxes. If imposed on income, on property, or on any separate part of produce, there must be a valuation of the object which is charged, affording opportunities for evasion and for arbitrary official action. It is true that the progress of society may be expected to reduce these objections. As acquaintance with the operation of taxation becomes greater the payers form a more accurate estimate of the amount that they pay, and will feel that direct levy is really no worse than taxation through the enhanced price of commodities.

Moral progress may also diminish the disposition to evade payment by creating a higher standard of social duty, and the better organisation of the financial service will reduce the risk of undue official pressure. Still, these evils actually exist, and the extent to which they are likely to occur must limit the employment of direct taxation.[1] Again, under a system of pure direct taxation it is very difficult to obtain their due proportion from the poorer members of society. The attempt to carry the income tax at a high rate down to the smaller incomes now exempt would be both costly and irritating, and the only produce tax that would much affect them—that on wages—would be still more obnoxious. No doubt with moderate expen-

[1] Cp. Vocke's remarks, *Abgaben*, 624–5 ; also *Finanzwissenschaft*, 355.

diture and an improved standard of social morality the difficulty would become manageable, but we cannot assume the existence of these favouring conditions without adequate proof.[1]

It is, moreover, alleged that direct taxation is inexpansive, that it does not grow in proportion to the increase of national wealth. This, however, is not altogether correct, and so far as it is true can be accounted for without difficulty. The growth of so important a direct tax as the English income tax since its re-establishment in 1842 has been very remarkable. The yield per penny for the first year was only £730,000; in 1901–2 it passed £2,500,000, or far more than a threefold increase[2] in sixty years. Indeed, the only explanation that can be given of a slower increase in an income tax than in income is that of evasion by the payers, an objection already considered. But in fact there are special reasons for the slow growth of certain direct taxes. A tax on rent will not increase in proportion to the growth of income, as it is generally fixed for a period of some length. The French land tax cannot increase, since it is apportioned and therefore fixed in amount, and in all cases of valuation it is not easy to keep the assessments up to the actual gains.[3] The counter-advantage that, in a progressive society, these taxes tend to become lighter while yielding a definite amount ought not to be overlooked. It is a benefit to have one part of the revenue that can be depended on even in times of crisis. Taking the defects and merits together, we believe that direct taxation ought to be a part of every modern financial

[1] See Cliffe Leslie's forcible argument in *Cobden Club Essays* (2nd series), 252 sq.

[2] Ireland was not included till 1853, but the abatement limit was raised, which probably compensated for this addition, and since then there have been great extensions both of exemption and abatement.

[3] *E.g.* in Ireland Schedules A and B of the income tax, so far as land is concerned, are taken on a fixed valuation, and therefore cannot expand in the same way as in Great Britain. They may, however, decline, as the landowner has the option of paying on rent instead of on valuation.

system, and that the extent to which it can be carried will depend on the particular conditions.

§ 9. The weak points of direct taxation are the strong ones of the opposed form. Indirect taxes are not felt by the payer in the same degree, and therefore cause him less annoyance. A tax mixed up in the price of wine, tea, or tobacco is not brought so clearly to his mind: it seems to be a part of the expenses of production, and to be due to purely economic causes. If 'the best tax is that whose forms most effectually disguise its nature'[1] there can be no doubt of the superior merit of indirect ones. A second advantage is the facility that they supply for taxing the smaller contributors. Duties on articles of general consumption touch all classes, though if necessaries are exempt they leave the minimum of subsistence unaffected, but only on the condition that the minimum revenue is expended for that object. Thirdly, they are both productive and in times of prosperity elastic without undue pressure. The growth of the English excise and customs, in spite of great reductions, has been remarkable. Again, it has been often pointed out that taxes on commodities are collected at a convenient time, since the contributor 'pays them by little and little as he has occasion to buy the goods . . . . he is at liberty, too, to buy or not to buy, as he pleases.'[2] This remark of Adam Smith's has been extended to the assertion that indirect taxation is preferable as being 'voluntary.' There is no necessity to pay unless the contributor is willing. This, if true, would be a disadvantage, but, as Mill has shown,[3] it is untrue. A citizen can, indeed, escape a wine duty by not consuming wine. That course, however, has the double disadvantage of depriving the State of revenue and of diminishing his own enjoyment. In the case of a direct tax of equal amount the same saving would be made by giving up the use of wine, and the

[1] Gaudin, *Mémoires*, i. 217.
[2] *Wealth of Nations*, 348.
[3] *Principles*, Bk. v. ch. 6, § 1.

revenue would not suffer.[1] The possibility of checking consumption is a bad rather than a good feature in taxes on commodities. Other defects are easily discoverable. The rule of equality appears to be frequently violated. Articles of general consumption are used in much larger proportion by the poor than by the rich, so that in any modern fiscal system the pressure of indirect taxation comes chiefly on the working classes. Expedients may be suggested to diminish this evil. Articles of luxury may be subjected to heavy taxation, and the rates of duty may be fixed according to the quality of the articles taxed. Such measures, however, give rise to further difficulties. Articles of luxury are easily smuggled, and *ad valorem* duties lead to evasion. In spite of any possible alleviations, the remaining inequality must be considerable. The elasticity of indirect taxes has its unfavourable side. At times of depression their yield cannot be relied on; as they grow in prosperous years so do they shrink in bad ones. Nor are they easily extended. Increased duties may possibly give stationary or even diminished receipts.[2] Reliance on indirect taxation alone

[1] The doctrine that indirect taxation is voluntary is accepted by Sidgwick. 'It is urged that direct taxation, being inevitable, is a greater burden than an equal amount of taxation voluntarily incurred by purchasing commodities. And I think that this cannot be denied,' *Elements of Politics*, 175. He applied it to the case of Irish taxation (Financial Relations Commission, ii. 182), and was followed by Mr. A. J. Balfour. Assuming, however, that a certain amount has to be raised by taxation, it follows that abstinence from the consumption of taxed commodities will make it necessary to tax fresh commodities, and when all have been taxed to use direct taxation, which might better have been employed at first. Taxation which checks consumption is unproductive and burdensome through privation to the people. Prof. Edgeworth ingeniously points out that under indirect taxation there will be 'a loss of consumers' rent, which does not occur when the amount is directly subtracted from income,' and therefore regards taxes on commodities as 'more burdensome than direct taxation,' *Economic Journal*, vii. 568. Consideration of this matter shows the inaccuracy of estimating the weight of taxation by the yield of taxes. Thus the yield of the tea duty in Ireland for 1901–2 is only 25 per cent. more than that for 1899–1900, though the duty is 50 per cent. higher. In studying the effect of taxes the *privative* side of their action should never be overlooked.

[2] The increase of duties in 1840 by Baring is an instance; 5 per cent. extra all round did not give increased receipts, Dowell, ii. 313.

will therefore sooner or later cause financial embarrassment.

Expenses of collection are probably somewhat larger in the case of indirect taxes, though the difference is not so great as is often asserted. The cost of collection of the English Inland Revenue (about one-half of which is direct) is less than that of the customs, but so much depends on special conditions and the amount of revenue to be raised, that a general conclusion on the subject would be misleading.

By far the most formidable objection to the indirect taxation of commodities is the loss to the society through disturbance of industry. The evils of both customs and excises in this respect have been forcibly shown by Cliffe Leslie.[1] The former close some ports altogether on the ground that there is not trade sufficient to justify the expense of maintaining custom-houses at them, and limit the imports of taxed articles at others. Towns without bonded warehouses are at a disadvantage in competing with those that possess them. Industries are either prevented from coming into being, or have their development retarded by such regulations and restrictions. The excise system is injurious to the industries under its supervision, as it controls the processes to be employed, and hinders the introduction of improvements. Routine is necessary for effectual regulation, but it is fatal to the spirit of enterprise that is the main cause of industrial advance. The various items of this indictment are supported by specific allegations,[2] and there can be no dispute as to the gravity of the issue raised, nor as to the existence of the grievances stated. None the less are we compelled to hold that the retention of taxation on commodities is at present a necessity, and that by judicious measures it is possible, not indeed to remove, but to reduce the evils complained of. There are considerations other than those noticed by the

[1] 'Financial Reform,' in *Cobden Club Essays* (2nd series), 189-263; also reprinted separately. [2] Leslie, *ut supra*, 204, 205, 207–8, 219, 225–231.

assailants of these duties. All taxation is, it must be remembered, evil in its deduction of wealth and in the restrictive measures that must be used to make it effective. Direct taxation has its own inequalities and injustices, and is, besides, often vexatious and inquisitorial. A presentation of the faults of one particular form of tax-revenue is impressive, but should be qualified by considering the difficulties of any alternative method. In economics and finance we have always to be on our guard against the 'fallacy of objections.' Again, it is not clear that the taxation of a small number of articles has the very serious influence ascribed to it. Most of the instances of interference with industrial processes are taken from cases that no longer exist. The duties on salt, and glass, may have hampered invention, but in this country they are things of the past.[1] Apart from intoxicating drinks and tobacco, the industry of the United Kingdom may be said to be free from control for fiscal purposes. A further point may be noticed. The customs staff is not purely a revenue agency; inspection and supervision of the shipping industry is, or is generally assumed to be, needed for sanitary and police reasons. It is but one part of the system described in an earlier chapter,[2] and its whole cost should not be ascribed to the need of revenue. So far as the duties on stimulants seek to repress consumption, whatever hindrances they cause to the industry cannot be looked on as evil, since they conduce towards the object aimed at. The value of industrial liberty is doubtless great; whatever represses or diverts the economic forces that tend to increased production of wealth should not be allowed without adequate reason, and should be carefully watched; but on striking a balance it seems that the advantages outweigh the evils wherever a large revenue has to be obtained and where the system of indirect taxation is kept within narrow limits.

[1] The re-imposition of the sugar duty in 1901, though justified by the need of revenue, is open to the objection of hampering industry.

[2] Bk. i. ch. 4, 'Administrative Supervision.'

§ 10. On the borderland between direct and indirect taxation lies a large class, or rather several classes, of taxes, such as those on transfers of property, on ordinary contracts, on communication and transport, and in short the numerous charges on acts. All of them belong to the category of indirect taxes in the administrative sense, as do most of them in any sense of the term. They stand on somewhat different ground from duties on commodities, inasmuch as they in some cases approximate to fees for special services rendered, and in others are directly levied from the ultimate payers. They do not so much interfere with industry as with commerce in the strict sense, but they are open to the same kind of objections as those urged against the taxation of commodities. To hamper exchange is to prevent the passage of productive agents into suitable hands ; a tax on communications is a check on commercial intercourse, and duties on legal transactions, if widely extended, prove very troublesome and annoying to the most active and intelligent members of a community. For these reasons it is desirable to keep taxation of this kind as a subordinate resource applied only to a moderate extent, and chiefly with the aim of completing gaps in the financial system. The difficulty of making the pressure of these taxes at all proportional, or even of analysing their incidence, ought of itself to prevent their being made a principal source of revenue. But when used partly as fees for special services, partly as affecting forms of wealth that are very likely to escape their due share of taxation in other ways, and finally as affording valuable tests of the correctness of the returns to direct taxation, they have a good claim to continue as a subsidiary means of revenue, and as a relief to the pressure on visible income of the purely direct taxes, and on the general consumption of the community from taxation of commodities. The extent of their application must be decided with reference to the particular circumstances of the country and the opportunity for employing direct taxation.

§ 11. The system of finance best adapted for a modern society is accordingly one in which the objects of taxation are judiciously diversified in such a manner as to realise the ends desired. The usual source of taxation is national income, the mass of fresh production during the period under notice, and one most desirable part of the revenue system is that which directly receives from the shares of this fund a contribution towards the maintenance of the State. The rent of land, the interest on capital, the earnings of management, and the wages of labour may all, as the component parts of income, be rightly made contributory. Whether they should be imposable in their separate forms, or simply as income, is in principle immaterial, but the method of distinct taxes on each share seems to belong to a lower stage of development than the general income tax. To escape the difficulties—partly technical, partly political—that direct taxation by itself creates, the taxation of various 'objects' on which income is expended must generally be adopted. Instead of attacking wealth as it is acquired, its use is made the object of charge. The method of taxing producers and dealers, in order that they may pass on the charge to consumers, is a recognition of the tendency of certain taxes to shift their weight, and an effort to utilise that tendency in facilitating the collection of revenue.

Taxation of income and of commodities are the two great forms of revenue receipts whose importance overshadows all others; but while this is apparent in every budget, it is equally true that a certain proportion of revenue can be obtained by the operation of other charges that cannot easily be brought under either of the leading categories. Some transactions are well suited for the imposition of moderate duties. Communications may be made to yield no inconsiderable resource to the State, and above all the inheritance of property is at once a means of testing the accuracy of returns as to income and an opportunity for taxing masses of accumulated wealth.

These ingredients of a well-ordered system require to be combined in very different proportions at the several stages of development. In a new country, with sparse population and little capital, a direct income tax would be a very defective instrument. Where there is little foreign trade, and most commodities are produced and consumed at home, taxation of commodities is not, and cannot be, productive. Peculiarities of social organisation have, too, considerable influence. Taxation of inheritances is unsuited for communities such as India, where the family is the unit of society and property is rather corporate than individual.

How important the special circumstances of social life may be in this respect can be better realised if we consider how much of existing English taxation rests on the circumstance that wine, tea, and tobacco are not native products.[1]

§ 12. We thus get a well-defined system of taxation comprising the three departments specified in the preceding section, and it seems beyond question that this will for a long period be the prevailing type. So far as any general course of development can be traced, the movement is towards a greater use of direct taxation. The income tax —a product of the nineteenth century—is on the whole increasing in favour, and the imposition of higher duties on inheritance is also probable.[2] The great importance of both excises and customs is nevertheless a prominent feature. We cannot see how the existing outlay of any modern State could be maintained without their aid, though we shall indeed discover that they are confined to central finance, and are unfitted to be local resources.[3] Still, the general conclusion is clear, that the great divisions of the tax system are likely to remain in active use, partly no doubt in consequence of their suitability to the existing

[1] The last-named only through the legislative prohibition, slightly relaxed in the past few years.

[2] The great increase in the English death duties in 1894, and the recent changes in France, support this statement.

[3] See Bk. iii. ch. 6, § 3.

financial organisations, but far more on account of their serviceable qualities.

A further advantage of this combination should be noticed—its elasticity. In modern finance it is desirable that receipts shall be capable of easy adjustment to expenditure without inflicting undue inconvenience on the contributors. The employment of different forms of taxation tends to realise this object. The steady growth of the receipts from commodities in times of prosperity, the definite yield of direct taxes, and the power of altering the rate of the income tax, taken together, provide the conditions for securing such growth or contraction of receipts as may be thought most desirable.

CHAPTER V

THE SHIFTING AND INCIDENCE OF TAXATION[1]

§ 1. Up to the present we have avoided all but the most incidental mention of the difficult problems connected with the real as opposed to the apparent pressure of taxation. This course has the great convenience of allowing an acquaintance to be made with the leading features and general guiding rules of the system, free from the complications that are inherent in any discussion of the question of incidence. The omission must now be remedied: we have to consider the nature and consequences of the series of processes usually known as shifting or repercussion of taxation, and to study the effects produced by them on the financial organisation. A correct solution of the problem is indispensable for full knowledge of the subject. Our judgments on every part of the tax system will be affected by our theory of incidence. Take, *e.g.* the question of

[1] On this difficult subject reference may be made to Professor Seligman's masterly study, *The Shifting and Incidence of Taxation*, the first edition of which appeared at the same time as the first edition of this work. It, especially in the second enlarged edition (1899), enters into special points both of history and of theory at much greater length than would be allowable in a general manual. The large amount of agreement between Professor Seligman's conclusions and those set forth in the text affords a gratifying confirmation of their correctness. Professor Edgeworth's series of articles on various aspects of incidence are highly important. See his 'Theory of International Values,' *Economic Journal*, iv. 435 sq.; 'Pure theory of Taxation,' *ib.* vii. 46 sq., 226 sq.; 'Incidence of Urban Rates,' *ib.* x. 183 sq., 340 sq., 487 sq. See also the collection of opinions in *Memoranda on Classification and Incidence* [C. 9528].

justice. How can we say that any given arrangement of taxation is fair unless we know its real, not merely its apparent, incidence? The extent and limits of the shifting of taxation are elements in estimating the expediency of exempting the minimum of subsistence, of imposing a progressive income-tax, or of taxing articles of consumption. Instead of confining our attention to surface appearances, we must examine the underlying conditions, and estimate in their entirety the effects of fiscal regulations.

This complicated investigation will occupy the present chapter. We shall seek to establish the general laws of repercussion and their most important results, reserving the treatment of the several taxes for the appropriate place.[1]

Here a question as to the proper use of terms arises. Most writers distinguish between the 'incidence' and the 'effects' of taxation, employing the former to denote the falling of the actual burden, and reserving the latter for the various economic results. This is the position of Professors Seligman and Adams. But the latter at least appears to limit the burden to the actual payment to the State.[2] It seems more in accordance with language and principle to treat the loss incurred by the citizen as coming under the head of incidence even though the State does not obtain revenue. The burden of many taxes is greater than their yield, but it is hardly admissible to cut up this burden into two parts, one, measured by state receipts, belonging to the topic of incidence, while the balance is treated as the 'effect' of taxation. Mr. Cannan proposes the heroic measure of discarding the term 'incidence' altogether.[3] But the expression is far too well established, and also far too convenient to be thus summarily abandoned.

§ 2. Popular discussion of financial matters has always

[1] See the sections on incidence in the several chapters of Bk. iv. (ch. 1, § 9, ch. 2, §§ 5, 13, ch. 4, § 11, ch. 6, § 16, ch. 7, § 7, ch. 8, §§ 2, 6, ch. 9, § 11).

[2] 'Manifestly there can be no payment by the citizen unless there is a corresponding receipt by the Government.' Adams, *Finance*, 388–9.

[3] 'I have no doubt that it is desirable to eschew the use of the term "incidence" of taxation.' *Memoranda*, 166.

given a large place to this special topic. The real incidence of tithes, of import duties, and of local rates has been hotly debated at many a dinner-table and in many a tavern, and very positive conclusions have been reached in entire ignorance of the grave difficulties that surround any attempt to determine accurately these and similar points. It takes some training to see that confident decisions as to the division of rates between landlord and tenant, or of duties between producer and consumer, cannot be made in a ready and off-hand way. Such is, however, the case. The complications are too great; the subtle modes in which pressure applied at one point is diffused over a wider area are too hard to be followed without a clear appreciation of the general conditions and a careful use of the slippery instrument of abstract deduction. In dealing with the problems of incidence we are at that part of finance that touches most closely on economic theory in its hardest form.

Scientific students have long recognised the fact, and the earliest efforts of financial inquiry have been directed to the question of the incidence of taxation. In some instances it was apparent that duties temporarily paid by the seller of a commodity were only advanced by him, to be obtained later on from the buyer in the form of increased price.[1] The extension of this result to all cases of taxation on producers or dealers was so plausible that it became an accepted doctrine of practical finance before passing into a theoretical form. This particular position dealt only with readily observed facts, and was confined to outward and apparent effects of taxation. A far more important step was made when the fruitful idea of a single source from which all taxes must, in the last resort, come suggested itself. The doctrine found a definite expression in Locke's statement 'that taxes however contrived, and out of whose hands

[1] Tacitus notes the fact in the case of slaves: 'Vectigal . . . venalium mancipiorum remissum, *specie magis quam vi*, quia cum venditor pendere juberetur in partem pretii emptoribus accrescebat,' *Ann.* xiii. 31.

soever immediately taken, do in a country where their great fund is inland for the most part terminate upon land.'[1] Put forward tentatively by Locke in connexion with his controversy as to interest, the conception of land as the true source of taxation was made the basis of a practical plan by Vanderlint,[2] and more fully developed by the Physiocrats as a part of their view of the 'net product.'

This earliest scientific theory of shifting rested on certain general assumptions, some of which we have already noticed.[3] They are (1) that wages are at the minimum point of subsistance, (2) that taxation of profits will drive capital out of industry, and by thus reducing the supply raise the rate to its former point, the tax excluded, and (3) that expenditure for consumption is simply the employment of income, and that increased prices through taxation will compel a compensatory increase of money wages and profits. By aid of these propositions it was easy to establish that taxation of wages or profits or their outlay must be passed on to some other class in society. The gains from commerce and professional avocations were brought under the same principle by the ingenious argument that they also were necessary to secure the continuance of the particular trade or profession.[4]

We thus obtain a rigorously complete theory of incidence accompanied by a description of the mode in which the shifting is carried out from the points of initial pressure to the ultimate resting-place. The equalising agency of competition and the necessity for normal wages and profits are the forces that push the burden of taxation on to the landowner's revenue. This conception of society as a mechanism in which strains were distributed in obedience to general laws, quite independent of legislation or intention, was

[1] 'Considerations on the Lowering of Interest,' *Misc. Works*, 595.

[2] For a full account of the views of the earlier English writers on these questions, see Seligman, *Incidence*, 11–91 (Part i. Bk. 1).

[3] Bk. iii. ch. 4, § 2.

[4] See Turgot, i. 442–4, for an application of this argument to the case of Holland, which had been brought forward to refute the doctrine of Quesnay.

thoroughly grasped by the physiocratic school, and was applied by them to the incidence of taxation as well as to economic distribution in general.[1]

The contrast so often noticed between Adam Smith and his French contemporaries, appears clearly in his treatment of the question of incidence.[2] The sharp and definite theory that regards all taxation except that on rent as necessarily shifted is changed into the broader doctrine that transference may or may not take place according to circumstances, and may fall on any one of the three constituents of income. In the application of these general positions several qualifications are introduced. Taxes on wages are always, Adam Smith holds, transferred, partly to the consumer in higher price, partly to the landlord in lower rent. The employer must have his ordinary profit, and he recoups himself for his larger wages' bill by increasing his sale price, or, if a farmer, by giving his landlord a smaller amount of produce. The share of profit known as employers' gain is also unamenable to taxation, as being merely the necessary reward of the entrepreneur.[3] Interest, though capable of bearing some of the public charges, is difficult to estimate, and its root, capital, is apt to emigrate when placed under exceptional charges. Taxes on necessary articles of consumption tend to raise the wages of labour, and therefore are, like direct wages taxes, passed on to the consumer or the landlord. A house-tax tends to fall partly on the occupier, partly on the ground-landlord, the builder in the long run always receiving his normal profits.

The result of the inquiries on incidence in the *Wealth of Nations* is a modification of the *Économistes'* view. Though the landlord is still the chief bearer of public charges which are shifted on to him from various points, while his special

[1] For the physiocratic doctrine of incidence see Quesnay, *Second Problème* (ed. Daire), 127 sq.; Turgot, i. 392–444; Seligman, *Incidence*, 96–112.

[2] There can, however, be little doubt that Adam Smith was much influenced by the physiocratic teaching on this subject.

[3] *Wealth of Nations*, 357.

burdens are not transferable, he is not the sole bearer: the capitalist has to contribute a share, and the vague class of consumers has to pay on the taxed forms of expenditure which may come from rent, profit, or even (in the case of taxes on luxuries) wages. The landlord has, nevertheless, as Falck remarks, the 'lion's share of the payment of taxes,' and therefore in part Adam Smith occupies the physiocratic position.[1]

The title of Ricardo's treatise marks taxation as one of its subjects, and it may be said that the space devoted to that topic is altogether occupied with the question of incidence. Adam Smith's positions are corrected in the light of the newer theories of population and rent. In fact, Ricardo's doctrine of taxation is a development of his theory of distribution. Notwithstanding the generally loose form of his writings, there is an amount of precision about his statements as to the movement of taxes that has made him the leading representative of economic orthodoxy on these points. Reduced to a definite form his views are represented in the following propositions, resting, it must be noted, on the assumptions of (1) self-interest as the motive power of action, and (2) the complete mobility —at least within the same country—of labour and capital.

(1) A tax on economic rent is not transferable; it remains on the landlord. (2) A tax on the wages of ordinary labour is transferred to the employer, and is in reality a tax on profits. (3) A tax on profits in general is not transferable, and must remain on the capitalist; but (4) a tax on the profits of a particular employment will be transferred to the consumers of its product. (5) Taxes on commodities paid by the producer are passed on to the consumer, as in the case of taxes on particular profits. (6) In the case of commodities consumed by the labourers there is a further

[1] See *Wealth of Nations*, Bk. v. ch. 2 pt. 2. For exposition and criticism of his views see Kaizl, *Überwälzung*, 3 8, and Falck, *Steuerüberwälzung*, 30–48.

shifting from the consuming labourers to the capitalists who employ them.[1]

The main outlines of this theory of incidence reappear in J. S. Mill's *Principles*, with some not unimportant amendments. For example, the higher classes of wage-earners are admitted as possible bearers of taxation. In their case a tax on wages may or may not be shifted. The results as to tithes and profits are somewhat altered, and greater emphasis is laid on the tendency of profits to a minimum. But these are special points: speaking broadly, there is no part of Mill's work which so fully deserves the description 'a readable Ricardo'[2] as that which deals with taxation.[3]

§ 3. The very general adoption of the Ricardian theory in its developed form as the sole and exclusive scientific doctrine makes it advisable to note some of the objections that prevent us from accepting it as a complete interpretation of the phenomena of incidence.[4] Some of these criticisms have been forcibly urged by Cliffe Leslie and Held, but they may be put in a more general form. The first weak point in Ricardo's position is his ambiguous treatment of consumption and consumers. In his general scheme of distribution there is no place for the consumers as a class, but we often find him asserting that a given tax does fall on 'the consumer.' How are we to explain this apparent discrepancy? The most natural answer is that landlords and capitalists make up this class, the labourers being normally outside it, as their consumption is a part of the expenses of production. This explanation is not completely satisfactory, for it is plain that all landlords and capitalists are not affected by particular taxes falling on consumers, and yet no criterion for distinction is suggested.

[1] On Ricardo's doctrine of incidence see Falck, 48–70; Kaizl, 8–11.

[2] Nicholson, *Introduction to Wealth of Nations*, 9.

[3] On J. S. Mill's differences from Ricardo see Falck, 71–90. He points out that 'Mill's doctrine of the operation of taxes differs but slightly and only on special points from that of Ricardo,' 71.

[4] Cp. Professor Seligman's remarks on Ricardo, *Incidence*, 117–121.

The necessity for studying the forms of expenditure as a department of economics seems clear from this consideration. Besides the pressure that falls on the primary divisions of income, there is the additional one on the employment of that income, and differences in its employment produce differences in pressure. A doctrine of incidence that is confined to the receipt of income without regard to its expenditure is so far defective. A second objection to the theory is its dependence on a few unduly simplified conditions. Social forces are regarded as definite and precise in their action, and very positive statements are made on the strength of this insecure foundation. Thus taxes on wages and on labourers' necessaries are regarded as being always transferred to the capitalist, a proposition true only on the assumption that wages are at the minimum, and that any change in them will at once act, and act proportionately, on population. In the same way the equality of profits and the complete dependence of rent on the margin of cultivation are made to support very sweeping propositions as to the incidence of taxation. If we allow that the economic forces of population, of competition in regard to the employment of capital, and the movement of cultivation are not quite so regular in their action, the deductions made from them must be qualified. Thirdly, the theory exaggerates the simplicity not merely of economic forces, but also of the forms of taxation. Taxes on rent, on profits, or on wages are not all the same, and the particular mode of imposition often affects the incidence. There is need for much care and discrimination in using those results of deduction that depend on the identification of so many different taxes. Finally, far too little notice is taken of the actual facts and of the unavoidable limitations in the application of theoretical principles. The orthodox theory of incidence professes to explain what will happen in the long run, 'but taxes,' as Leslie well remarked, 'are paid immediately under the real conditions of life and out of the actual wages and profits or other funds of individuals, not out of hypotheses or abstrac-

tions in the minds of economists.'[1] Knowledge of what will happen when the limit is reached is, no doubt, desirable, but what takes place during the process of adjustment should also be noticed.

The existence of these imperfections does not destroy the great service of the doctrine as a preliminary or introductory inquiry (*Vorstudium*). Without some such attempt the intricacies of incidence could never be explained, and it is by expansion and correction of the Ricardian procedure that advance can best be made in the explanation of these problems. As an intellectual exercise the abstract theory of the shifting of taxation has a high disciplinary value. The root-error of its followers lay in taking a part for the whole.

§ 4. The course of development in the preceding theories is clear enough. From the first suggestion of Locke to the compact exposition of J. S. Mill there can be traced a series of connecting links and alterations in consequence of wider knowledge. Adam Smith has the French theory constantly in mind, as Ricardo in turn has the ideas of the *Wealth of Nations*. All have in common the recognition of certain points on which the pressure of taxation ultimately rests, and all, it may be added, suggest the wisdom of adapting legislation to the conditions of incidence in order to secure a fair distribution, or at least to prevent unnecessary waste through friction.

Another group of doctrines has a quite different tendency. In place of investigating the complicated shiftings that settle the ultimate incidence, it either denies the possibility of ascertaining them, or assumes that they bring about a general diffusion of the burden over the whole society. The natural conclusion is that the particular forms of taxation are altogether immaterial, as, whatever be the immediate charges, the burden is finally distributed in an equitable, or inequitable, manner.

The first scientific statement of this view is ascribed to

[1] *Essays* (2nd edition), 384.

N. F. Canard, whose essay, attacking the theory that all taxation must fall on the owners of land, obtained a prize from the French Academy. The gist of his argument is that there is surplus product in labour and commerce as well as land, and that taxation falls on all of these 'net products.' The process of diffusion is carried out by exchange, buyer and seller in each transaction dividing the amount of tax imposed, and at every fresh exchange a division of the part of taxation transferred takes place until ultimately the charge is spread over all the parties concerned. Extending this conception to the whole society, taxation comes to be regarded as after a time diffused equably among all its members. The qualification as to time is important, for the process of diffusion is not complete at first; consequently old taxes are the best, and all new taxes, or even changes in existing ones, are to be deprecated as disturbing the beautiful and harmonious distribution which relieves the legislator of any trouble respecting the apparent merits or demerits of existing taxes.[1]

The comfortable nature of this theory has made it a popular one. Without adopting Canard's peculiar explanation of the mode of diffusion, Thiers asserts the general diffusion of the public charges; Stein, from a still different point of view, reaches what is practically the same result. In his opinion the whole theory of shifting is an error arising from imperfect comprehension of the real nature of the process, which in reality contains two different parts. For, first, a tax is a part of the cost of production similar to the expense of raw materials or labour, and like other expenses must enter into price, and taxation is through

[1] Canard's *Principles d Économie politique* appeared in 1801. See Kaizl, 11–15, for a clear summary, and also Seligman, *Incidence*, 125–128. An early statement of the theory, limited to taxes on commodities, is that of Alexander Hamilton. 'Imposts, excises, and in general all duties upon articles of consumption may be compared to a fluid which will in time find its level with the means of paying them. . . . In the course of time and things an equilibrium, as far as it is attainable in so complicated a subject, will be established everywhere.' *Federalist*, 124. Cp. *supra*, Bk. iii. ch. 3, § 15.

this medium 'diffused from one to another' until it extends to all. Again, from a higher point of view, the portion of product paid in taxes is a surplus product, the result of the services of the state administration, which pays back at least what it receives. The conception of incidence of taxation has to be replaced by that of the 'production of taxes.'[1]

This theory has also had a good deal of vogue in England amongst members of Parliament and officials, but is often held along with other and inconsistent theories. Thus, Sir E. W. Hamilton, after discussing at considerable length the incidence of certain taxes, finally comforts himself with the reflection that 'perhaps there is more truth than is popularly supposed in the optimistic theory of general diffusion, which is that "taxes equate and diffuse themselves, and if levied with certainty and uniformity they will, by a diffusion and repercussion, reach and burden all property with unerring certainty and equality."'[2] Sir R. Giffen expresses his full agreement 'in the opinion that all old taxation tends to become equally diffused over the whole community.'[3] So Lord Avebury makes the same quotation as Sir E. W. Hamilton, and approves of it in similar terms.[4] This does not hinder him from asserting that 'the Commissioners make out a very strong case for further relief to real property, especially after the additional burden thrown on it by Sir W. Harcourt's budget.'[5]

Closely allied to belief in the theory of diffusion is the disposition to regard the problem of incidence as insoluble, and at the same time to treat all questions of taxation as

[1] Stein, ii. 550–591. For the views of Thiers and Stein see Seligman, 129–132.

[2] *Memoranda on Classification and Incidence*, 51–2. (The quotation is from Mr. D. A. Wells.)

[3] *Ib.* 99. It is quite in keeping with this school of thought that he should immediately add, 'The case of old rates which tend to become a rent charge on the property affected is, however, a very special one,' thus mixing up the 'diffusion' theory with the 'capitalisation' theory.

[4] Address on 'Imperial and Local Burdens,' *Statistical Journal*, lxiv. 566.

[5] *Statistical Journal*, lxiv. 559.

if it were non-existent.[1] To deny that the incidence of taxation is discoverable seems to be the first step towards believing that it is unimportant.[2]

No lengthy criticism of the negative theory of incidence is needed.[3] Facts speak for themselves: if the incidence of the public burdens be really so settled that legislative action has no effect, how comes it to pass that some forms of taxation are much more oppressive than others? It is impossible to escape entirely the weight of a load by judicious arrangement of it, but it is quite feasible to diminish the fatigue it produces. Canard's doctrine is contrary to experience, and is not established by abstract reasoning. There can be no doubt that taxes are not always a part of cost of production, but in any case the real question is whether they can always be shifted by the immediate payer, and to this the answer must be a decided negative.

[1] This attitude is adopted in the 'Separate Report' of Sir E. W. Hamilton and Sir G. Murray, in which the problem of incidence is characterised as 'insoluble.' 'Incidence,' it is added, 'must in short be merely a matter of conjecture and speculation.' *Final Report on Local Taxation*, 109 [Cd. 638]. Lord Avebury also approaches the same position, *Statistical Journal*, lxiv. 559. (It may be noticed that he misrepresents Prof. Nicholson's opinion. That writer's assertion, 'that an answer is impossible,' is limited to the incidence of import and export duties, it does not apply to 'rates or taxes' generally. See his *Principles*, iii. ch. 10.)

[2] A prominent representative of this attitude is Held, who declares: 'Die Überwälzung ist gewiss kein reines Phantom, aber sie ist noch weniger im einzelnen Falle nachweislich.' *Einkommensteuer*, 145–6.

[3] Lord Avebury remarks that 'Prof. Bastable also condemns Canard's view.' He quotes the statement in the text, and adds, 'But unfortunately he gives no refutation either short or long.' *Statistical Journal*, lxiv. 567. Considering that the remainder of the chapter is devoted to setting forth a theory of incidence which is quite inconsistent with Canard's theory, and which, if true, completely overthrows it, this desire for a 'refutation' appears rather unreasonable. The best refutation of an erroneous view is the exposition of the true one. As Prof. Seligman well says (in a passage not quoted by Lord Avebury), 'The optimistic theory is so superficial that it scarcely deserves a refutation. . . . . Our review of the eclectic theories as well as the whole positive and constructive part of the present monograph will show the shallowness of the doctrine. Were the theory true there would be no need for any investigation like the present.' *Incidence*, 134. It is only necessary to add that none of the passages of this work quoted by Lord Avebury bears the meaning he appears to attribute to them. See § 9, *infra*, and Bk. iv. ch. 3, § 3.

The desire to pass on the burden may be universal, but the capacity to do so is limited. Even in the special case of taxes on commodities it is not always open to the producer to shift the duty to the consumer. As regards other taxes, the very idea of cost of production is quite inapplicable.

§ 5. In proceeding to examine more closely the conditions of our problem, it is well to remember that the total denial of the existence of shifting and the assertion of its universal existence are both unfounded. That, *e.g.* taxes on commodities are sometimes transferred by the immediate payers is an obvious fact. No one can believe that the distillers bear the whole burden of the English spirit duties. On the other hand, it is just as incredible that a landlord could entirely shift a tax on rent to his tenant or any other class, or that the payers of income tax could completely relieve themselves at the expense of others. The existence and the extent of the process of transference must depend largely on the conditions of the case, and it is these conditions that a general theory of incidence has to consider and explain.

The course of transference may be in different directions, and according to its starting-point and direction it is necessary to distinguish. Where the movement is from the producer to the consumer, or, more generally, from the seller to the buyer, there is 'forward shifting'; where it is from the buyer to the seller, there is 'backward shifting'; where the process of shifting affects more than two parties, it leads to 'diffused incidence.'[1]

The simplest instance of shifting is, as more than once mentioned, that in which the producer of a commodity passes on the charge in increased price to the consumer. A closer examination of this familiar case will suggest some important conditions. Why does the buyer submit to this

[1] The terms in the text are the nearest equivalents of 'Fortwälzung,' 'Rückwälzung,' and 'Weiterwälzung,' which are used by German writers, but with various minute differences. The process called 'Abwälzung' by Hock and Wagner should not be regarded as belonging to the subject at all. See Hock, 96; Wagner, ii. 346–8.

additional charge? An increase in price tends to reduce demand, and will not the falling off bring about a return to the old level? The usual reply would be that the dealer or producer had been obtaining normal profits before the imposition of the tax, and that without an increased return sufficient to compensate for the new charge he would not, or could not, continue in the business. The doctrine of average profits resulting from the effective mobility of capital is thus the foundation of the proposition that taxes on commodities levied on the producer are shifted to the consumer. The reason for the proposition also shows its limitations; wherever an industry is yielding such exceptional gains that taxation will not reduce them below the supposed normal level, the motive for abandoning the employment not being present, the force that produces shifting will not be in operation. It may therefore be allowed that, so far as producers' gains are at all of the nature of monopoly, taxation will specially affect them. But here a further qualification is presented. Exceptional gains may be made by some producers, but not by others; in fact in nearly every industry some of those engaged in it can barely hold their ground. This unfortunate class must, on the increase of taxation, either raise their price or leave their business; if they can succeed in the former attempt, their successful competitors will gain by it, and shift their charge to the consumer; if they fail, the margin of pure profit is raised, and the burden will remain on the producers. It is possible, and indeed likely, that the actual result may be a compromise. Some of the weakest producers may be driven out, but the price may also be somewhat raised, in which case there will be division of the charge. Therefore the true conclusion is, that when there is complete mobility taxation will be shifted from producer to consumer. Again, the possibility of shifting taxation of the kind under notice does not depend simply on the elasticity of supply; the effect that changes in price will produce on demand must be considered. Taxation imposed

on a necessary article, or one which forms a very small part of the total outlay of the consumer, will, since demand is inelastic, be more likely to pass on at once to the consumer than if the commodity belonged to that large intermediate class, the demand for which is speedily checked or increased by an upward or downward movement of price.[1] Again, if increased expenditure has to be devoted to taxed articles, less remains to be applied in the purchase of other goods ; the consequent reduction may lower prices in other industries from which withdrawal is not economically expedient, and accordingly diffuse the indirect incidence of the tax to a different set of producers. Further, it must be remarked that as all industrial processes are really complex, it is quite possible that a tax may not affect the holder of floating capital who is ready to seek other investments, but may fall entirely on the owners of land, or specialised capital suitable for the production of the article. Both land and fixed capital are indeed capable of different uses, but the alternative ones are necessarily less profitable than that in which they are actually engaged. Hindrances to mobility are hindrances to shifting of taxation. The very application of a tax of itself produces disturbing effects. Additional capital has to be employed, restrictions, which mean the sacrifice of time and money, come into force, both tending to reduce the number of producers and to concentrate industry. The production approaches to a qualified monopoly, and thus the weight of taxation falls, so far as actual receipts are concerned, on the consumers, with a further loss to the small producers excluded from the business.

The case of a strict monopoly is of sufficient theoretical importance to receive some special notice. Starting from the admitted fact that the normal monopolist endeavours to make his net return as high as possible, it follows that a tax on the commodity that he produces will, by increasing his expenses of production, tend to reduce his net receipts, but whether the whole or even the greater part of the tax will

[1] Cp. Seligman, *Incidence*, 148 sq. ; also Jevons, *Theory*, 161 sq.

be borne by him or by the consumers will depend on (*a*) the conditions of demand, and also (*b*) on those of supply. If a slight rise of price seriously checks consumption, or, in other words, if the demand is elastic, the monopolist suffers more than in the case of inelastic demand. Again (*b*) if the condition of diminishing return operates, the tax may, and probably will, be in part compensated by the cheaper production of the marginal portion of the reduced supply. The condition of increasing return makes a tax more oppressive, since the cost will rise with contraction of supply.

But the theoretical conception of a pure monopoly is of little direct service in dealing with the question of incidence; for in very few cases is a monopoly strictly so called to be found. There is in truth rather a number of instances of limited or qualified monopolies, arising in part from natural, in part from legal limitations. Both monopoly and competition have to be considered, and in particular the interaction of these opposed conditions as well as the effect of financial changes in readjusting these areas.[1]

The precise method of taxation employed will have an important influence; whether the duty be imposed at an early stage or allowed to lie over till the article is ready for the consumer; whether the measure adopted is supposed capacity of production or actual product are very material circumstances in deciding the exact incidence.

Thus the apparently simple case of taxation of commodities appears to be really surrounded with complications that need close and careful study. The same questions would arise if the tax were levied directly from the consumer; there would be the possibility of a backward shifting, just as there is of failure of the forward one. In fact, as the position is sometimes explained, there is a struggle between producer and consumer, each striving to

[1] For the economic theory of taxation of monopoly, see Marshall, *Principles*. (3rd ed.) Bk. v. ch. 13, § 4. Also the articles by Edgeworth already referred to, especially *The Pure Theory of Taxation*, No. ii. (*Economic Journal*, vii. 226–38). Cournot seems to have laid the foundation of the scientific analysis of monopolies in his *Principes Mathématiques*, chs. 5, 6.

throw the loss on the other, and much will depend on the relative strength of the parties. As a rule producers are a smaller and better organised class, and therefore have the chances in their favour, though where they possess any differential gain, this advantage is lost to them. Fresh increases of taxation are passed on to the consumer more readily than reductions are restored to him. This element of friction has another effect. Small additional amounts of taxation are not easily shifted ; a few pence on or off the gallon of spirits cannot directly influence retail price. The initial shifting always implies an effort, which, however, very readily takes place in industries accustomed to alter prices as the various expenses of production change. Additional taxation and a rise in the price of hops are events of exactly the same kind to the brewer, and their final result is distributed in the same way.

The diffusion of the burden may be still more complicated. In modern society products pass through the hands of several distinct classes before reaching the consumer, and the struggle of buyer and seller will be repeated at each separate stage. The existence of monopoly or of some form of limitation at any point may prevent the shifting passing any further. An economically strong intermediate group may throw a charge back to the producer, send it forward to the consumer, or divide it between both.

The foregoing analysis of the actions and reactions that may accompany or result from the imposition of a tax on a commodity shows the general conditions that are influential.[1] They are (1) the presence or absence of mobility ; in the former case, the normal shifting to the consumer will take place ; in the latter it is retarded : (2) the law of demand for the particular commodity ; on this depends very much the extent to which there will be a reflection of the burden either back to the producer or to

[1] Cp. the more elaborate enumeration in Seligman, *Incidence*, 181, which applies to taxation in general rather than to the special form of taxation on commodities.

other industries: (3) the presence or absence of monopoly: (4) the method of taxation as affecting the preceding conditions: (5) the organisation of the industry and its division, and (6) the amount of taxation. In regard to this last circumstance, it may happen that additional taxation will increase the force of competition. The new element may be just the last thing wanting to break up the existing settled conditions. This will be easily understood by considering the effect of successive very small additions to the duty on a given article. Each of these will tend to remain on the payer, but as soon as the additions are sensible, or easily distributed, the shifting movement will begin to act. Even in the case of the most rigid and gainful monopoly, the producer must, if taxation be carried sufficiently far, either pass on the weight or abandon the undertaking.

§ 6. The comparatively easy case of a tax on goods enables us to perceive the general character of the changes in incidence produced by the process of shifting. We have now to deal with the more important and interesting question of the movements of incidence in respect to the incomes of the different economic classes. The whole tendency of modern economic science has been in the direction of emphasising the fundamental similarity between the departments of exchange and distribution.[1] Rent, wages, interest, and employers' earnings are exhibited as the prices of the respective services of land, labour, capital, and business ability. Might we not say that a tax on any of these commodities would be amenable to the same reasoning as that already applied to material goods, the consumers of each of the factors of production being those other factors that need its co-operation? This mode of treatment is, we believe, unsuitable, owing to the distinguishing pecularities of the shares in distribution. Their production is not in

[1] 'The theories of the values of labour and of the things made by it cannot be separated; they are parts of one great whole.' Marshall, *Principles*, Preface, viii.

the same form or subject to the same conditions as that of ordinary commodities. Nor is the nature of demand the same in respect to them. The attempt to bring commodities and services under a common heading seems to be an undue straining of the analogy that undoubtedly exists. A better mode of dealing with the question is rather to consider it in the light of the theory of distribution, while availing ourselves of whatever is applicable in the case of taxation of material commodities.

There is no need for attempting here to re-state the economic theory of distribution. The work of Ricardo has been filled in and placed in closer relation to actual conditions by the ablest workers of the past and present generations,[1] who have carefully elaborated the originally fragmentary doctrines on the subject. The main conditions affecting changes in distribution must, however, be noticed; for the effect of taxation is plainly a deduction from the total produce—*i.e.* so much loss to be re-distributed among the parties concerned.[2]

Assuming competition, the main circumstances on which the amount of rent depends are the position of the margin of cultivation, and the several qualities of land that lie above it. Change either the worst land in cultivation, or the relation to it of the superior soils and the quantity of rent will be altered.[3] In estimating the incidence of a tax on rent, its effect on these conditions is the first consideration. The usual way of showing that a tax on rent cannot be shifted is to point out that it does not affect that particular

[1] See Ricardo, *Principles*, chs. 1–6; J. S. Mill, *Principles*, Bk. ii.; Sidgwick, *Principles*, Bk. ii. chs. 6–9; Walker, *Political Economy*, pt. iv.; Marshall, *Economics of Industry* (1st edition), Bk. ii. chs. 6–12; *Principles of Economics*, Bk. vi. chs. 4–11; Nicholson, *Principles of Political Economy*, Bk. ii.

[2] The increased produce that wisely expanded taxation provides is not a determinable quantity, otherwise it would perhaps be possible to regard it as the source of taxation, as the older theory of State services suggests.

[3] The facts that land may vary in productiveness either from fertility or situation, and that cultivation may be either extensive or intensive, make the statement more complex, but do not alter its essential nature.

land that pays no rent, and consequently leaves the determination of the total amount, including the tax, as before. Ricardo and some of his nearest disciples differed as to the incidence of tithes or proportional taxes on the raw produce of land. The former maintained that such a tax must fall on the consumer, since in the case of produce from the worst land in cultivation there was no rent on which it could be placed, and it was the yield from this land that determined price ; as the cultivator would need his average profit, the shifting to the consumer was necessary. Senior and McCulloch, on the other hand, held that the rise of price would check demand, and therefore by changing the position of the margin in an upward direction would reduce rent.[1] Without discussing the special point at issue, which belongs to the group of land taxes,[2] we see that the criterion used by both is the effect on the general condition of agricultural industry. That on the hypothesis of perfect competition a tax on rent must remain on the payers is an indisputable truth, but for the cases of actual taxation it is important to bear in mind that economic rent is mixed up with other elements. The investment of capital in land yields a return in many instances indistinguishable from economic rent, but at the same time it is 'really the profits of the landlord's stock.'[3] So far as no discrimination can be made between these components, the incidence of a tax will fall to some extent on the return to capital, and, if sufficient to discourage its investments, will tend to be passed on to the consumers of agricultural products, since land of inferior natural quality must be cultivated in order to supply the required quantity.

The opposite cases of taxes imposed elsewhere falling on rent is much more probable. The class of differential gains of which rent is one very conspicuous instance is peculiarly liable to be affected by taxation. The influence of com-

[1] See Ricardo, *Works*, 104 ; Senior, *Political Economy*, 123 ; McCulloch, note 30 to *Wealth of Nations*.

[2] See Bk. iv. ch. I.

[3] Ricardo, 102.

petition is, speaking generally, effective in distributing special burdens on a particular industry; but where special gains have been obtained an equivalent tax is the restoration, not the destruction, of equality. This is the kernel of truth in the Physiocrats' belief, and on it their exaggerated doctrine was based. No kind of actual tax can be imagined which might not under certain conditions diminish the fund that goes to the landowner. Wages, interest, employers' receipts, duties on goods, or on acts, all supply such examples, and they all accomplish their effect by operating on the margin of cultivation in the widest sense. The complicated working of the tax-system is very well shown by this circumstance. It is, as we discovered, very difficult to single out differential gains for exclusive or extra taxation, but the ordinary agencies of economic life are tending to that object, though of course in a very limited and imperfect way. They strike alike the earned and the unearned increment, the investment profitable through the foresight of the prudent employer and the lucky chance of the rash speculator, the rents of careful and improving as well as of inattentive and tyrannical landlords.

§ 7. Taxation of the capitalist's share of the national income gives rise to more difficult problems than those connected with rent. Between the doctrine of Turgot, that a tax on profits is always, and that of Ricardo, that it is never, shifted,[1] we have to take an intermediate position. A general tax on interest, as it affects all employments equally, would appear certain to remain on the payers. The mobility of capital cannot here, so long as we confine our attention to a single country, have any effect. Where the tax does not extend to capital invested abroad it is evident that it would discourage home investments and lead to the emigration of wealth to other places. 'The proprietor of stock,' as Adam Smith tells us, 'is properly a citizen of the world, and is not necessarily attached to any

[1] Turgot, i, 63; Ricardo, 122.

particular country.'[1] Even within a limited area another feature of capital will affect the incidence of special taxes imposed on it. Unlike land, it can be indefinitely increased by human foresight and providence, having as a chief inducement the return to be obtained by investment. Taxation on interest lowers that return, and is therefore a direct discouragement to saving.[2] So far as it is effectual, the diminution in the supply of available capital tends to raise the rate of interest and transfer the incidence to the consumers of capital, *i.e.* the other factors in distribution, and as rent is not likely to be much affected, in reality to the producers, including both employers and labourers. How far the check to production will show itself in a higher cost of production and therefore fall on the consumer is not easily determinable; if there were to be a substantial check to the investment of capital this would be a probable result, causing a diffusion of the incidence, some of it returning to the capitalist in his capacity of consumer.

For most purposes of economic reasoning there is an advantage in neglecting the differences between the different forms of capital and dealing solely with the characteristics common to all. But in handling the problem of incidence, it is necessary to see that there are two broad classes of reproductive wealth, the one free and capable of being turned in any direction, the other fixed in some particular industry. It is primarily to the former that the arguments from the mobility of capital apply. Capital once invested, the difficulty of withdrawing it places the possessor for the time being in the same position as the landlord. A tax on fixed capital would thus seem to resemble in its effects a tax on rent, and to be equally untransferable. One instance

[1] *Wealth of Nations*, 358.

[2] The effects of a rise or fall in the rate of interest are not quite simple. Speaking broadly, the tendency on balance is that a rise in interest encourages, and a fall checks, accumulation; but 'the growth of material capital depends on a number of variables,' Nicholson, *Principles*, i. 394, cp. 209–10. Cp. Marshall, *Principles*, 316–8. For an attempt to minimise the effect of the rate of interest on accumulation, see S. and B. Webb, *Industrial Democracy* 610–627.

—that of land improvements—has been already discussed, and in considering it we saw that the mode of relief to the capitalist was simply by reducing future investments. The single tax on fixed capital in the sense used by Menier and his followers would be at first a heavy burden on the owners of those forms of wealth, that would show itself later on in reduced investment and retarded production. Free capital, if separately taxed, has much readier modes of escape. Employment outside the particular tax area makes it very difficult, even if the law enacts it, to enforce collection ; consequently the chance of placing an effective tax on movable capital is much reduced by both economical and technical circumstances.

The chief condition, then, on which the incidence of a tax on interest depends is its effect on the accumulation and investment of capital, including its action on the saving propensities of the inhabitants and their disposition to move their wealth to escape taxation. If the rate of interest is determined by what Jevons calls the 'final utility' of capital, it is plain that the possibility of shifting the tax will depend on the effect produced on this margin of investment. If it is forced up the weight will be transferred from the recipients of interest to that intermediate class which gains by the cheapness of capital.[1] A tax on the returns of fixed capital will at first rest on the payers, and only be transferred with difficulty, but it will ultimately, when the old supply is sufficiently contracted, come under the same influences.[2]

Mixed up with the interest of capital in Ricardo's treatment of taxes is that element of profit variously described as 'wages of superintendence,' 'earnings of management,' or 'employers' gain.' It has, however, strong claims to separate treatment. The profit of the entrepreneur has

[1] 'Either the labourers themselves or the public generally as consumers' is Jevons's statement. *Theory*, 278.

[2] Prof. Marshall's conception of 'quasi-rent' is useful here. *Principles of Economics* (3rd ed.), 477–8. During the short period the capitalists bear taxation ; in the long period the process of shifting is carried out.

some points of resemblance with wages, as it has others with rent, and we must therefore be prepared to find that the movement of taxation is different in its case from that of ordinary interest. The analogy of rent would lead us to believe that a tax on the gains of the employer could not be transferred, since there would be no opportunity for escape on the part of the immediate bearers. A tax on this very indeterminate element of the gross profit of business would, however, be certain in practice to trench in some degree on the other constituents. It is almost impossible to avoid levying such a tax on that minimum 'employer's return' which is sometimes regarded as equivalent to 'no profits.' The struggling marginal producer will then need an increased price in order to recoup himself for the tax, and unless he obtains it will have to yield to the pressure of the 'last straw,' and therefore abandon his business. Taxation of this kind would operate somewhat as taxation of commodities. It may be urged that when the gains of all industries are taxed there is no reason for the weaker employers giving up business. They can, however, pass down to the class of labourers, as others by taxation may be hindered from leaving it.[1] The effect on the marginal employer appears as the condition determining the shifting of taxes on the employer's gain.

This share of national income may also suffer through the operation of taxes on commodities. When such a duty is not transferred to the consumer the burden is likely to fall on the differential element in profits; the tax has to be paid without the compensation of a rise in price, and there is no way of shifting the burden, unless in the case of raw materials, where rent may be curtailed. It is quite in accordance with the analogous case of rent that taxes should be shifted to the peculiar gains of the employer. It is,

[1] 'It is laid down that taxes on the profits of all employments fall on capitalists only, and cannot be shifted on any other class. But there is in reality a perpetual migration along the borders between capital and labour, as there is also an intermediate class who individually may be regarded as capitalists or workmen.' Leslie, *Essays*, 390–1.

besides, possible that a tax on interest may be transferred to profit in the limited sense. When the rate of interest is raised, as we have seen that it may be, by taxation, the employer has to pay dearer for his borrowed capital, and, so far as what he works with is his own, loses on one hand what he gains with the other. On the whole we may confidently say that the broad and simple statement that taxes on profits fall on the capitalist, who can in no wise transfer them to others, requires to be very much limited before it can be accepted as correct. We must separate the two essentially different elements of interest and employer's gain, and recognise that while the one is affected by changes in the point of final utility of capital, the other is connected with the opportunity for profitable industrial effort.

§ 8. If the older theories on the subject of incidence assumed too hastily that rent and profits had to bear their own immediate burdens and under certain conditions those of others, they made amends when dealing with wages. The transference of taxes on this part of revenue was asserted in the most positive manner.[1] The landlord, the capitalist, the consumer might all be affected by a tax on wages, but the labourer was always exempt from contributing to the requirements of the State. This immunity was believed to extend to the higher kinds of wages and salaries, since they had a fixed relation to the ordinary rate.[2]

The historical explanation of this belief is afforded by the evolution of the system of hired labour from the earlier condition of serfdom. The slave as an instrument of production received what was needed for his maintenance; any reduction in its amount would reduce his efficiency. Taxa-

[1] 'Les taxes établies sur les salariés, ou sur leurs dépenses, sont donc évidemment payées en entier por ceux qui payent leurs salaires.' Quesnay, 'Second Problème' in *Œuvres* (ed. Oncken), 706.

[2] 'The recompense of ingenious artists and of men of liberal professions . . . necessarily keeps a certain proportion to the emoluments of inferior trades.' *Wealth of Nations*, 366 ; cp. Turgot, i. 444. The salaries of state officials are the only exception allowed by Adam Smith.

tion was paid altogether out of his master's income, it did not concern the living machines engaged in the creation of wealth. This conception survived in the earlier period of free labour, and gained support from the doctrine of a 'natural' rate of wages common to the French and English economists. Any reduction in the rate would, it was held, act on population, and by diminishing its number restore the former real reward of the labourer. In spite of occasional concessions, such was the opinion of Turgot, of Adam Smith, and of Ricardo,[1] and, given the premise, the conclusion was sound enough. It is also true that in both the France of the eighteenth century and the England of the Napoleonic war wages did seem to have touched the subsistence point, and to give a direct verification of the economical doctrine. But, strange to say, no notice was taken of the fact that one of the causes of this deplorable situation was the heavy and unequal pressure of taxation. The French peasant and the English labourer were the greatest sufferers by the fiscal systems under which they lived, and financial reform was one of the means of their relief.

No account of the incidence of a tax on wages can be satisfactory that does not fully recognise the existence of varying standards of comfort, even among the lowest unskilled labourers at different times and places. Beside and above the physical minimum, there is what Mill calls a 'moral' minimum. The conditions must be exceptionally unfortunate that do not allow the labourer something above mere subsistence, and, when that minimum point is exceeded, there is something on which taxation may fall. To estimate the incidence of taxation we must know its effect on the standard of life. If that is maintained unaltered there will be a transference of the tax to the capitalist or employer; if it is lowered the labourer bears the tax himself. This consideration applies to each industrial grade, but it is evident that the higher the usual scale is placed

[1] See the passages already quoted.

the less is the probability that it will be readjusted to suit taxation. When a group of labourers possesses a monopoly, it, in common with all holders of differential gains, has no power to throw off the burdens imposed on it, and, as most skilled labourers have more or less special advantage, the shifting of taxes is in their case beset with difficulty.

Thus, as in the case of rent, interest, and profit, we find that the ultimate incidence of a tax on wages will vary according to the special conditions under which it is imposed; and of these the most important are the effect on the usual standard of living, and, so far as the higher kinds of wages are concerned, the extent to which their receivers are privileged through natural or artificial causes. Peculiar gains of labour are just as much at the mercy of fresh taxation as any other differential advantage. The process of shifting requires the actual exertion of force to carry it out, and those forces can only be the agencies that work through supply and demand. If the same supply of labour of any particular kind is forthcoming with an unchanged demand, then direct taxation of labour will not be transferred. The great difficulty of adjusting the supply of labour is a reason for believing that any shifting of taxes imposed on it must be a slow and uncertain process.

A similar conclusion applies to the case of taxes on the labourer's consumption. We do not find that duties on food produce higher wages; they only bring the starvation point nearer, as the history of the English Corn Laws shows. When Ricardo argued that taxes on articles of the labourer's consumption are exactly the same as a tax on profits he assumed far too rigid a connexion between the cost of living and the supply of labour. A tax on the food of animals used in production would increase cost, because food so given is regulated to secure efficiency, but the labourer seeks to procure the best terms for himself. The element of free contract present in the latter case entirely alters the position. For completeness of statement it is desirable to add that a great deal of wages is really the

return on capital invested in the education of the workers, but in reality this does not produce as much practical effect as might be expected. A tax on wages, unaccompanied by an equivalent tax on the yield of material capital, would apparently discourage expenditure in the formation of personal or immaterial capital, and turn it towards the production of goods. This check to the supply of trained workers would tend to raise the price of their services, and shift the pressure to the consumers of the goods produced by them or to the employers. In practice the calculations of parents and others who make the investment in the education of the young are not so carefully worked out as to be influenced by the existence of a tax on the wages of the higher employments. Still, even with the actual imperfect estimates, some effect would probably be traceable if the tax were a heavy one. The necessary expenses of living in a suitable way and the cost of training are the two agencies that give some justification for Adam Smith's doctrine of a balance not to be disturbed by taxation between the different employments.

§ 9. Our examination of the general conditions that help to determine the true incidence of taxes on the different constituents of income, though necessarily brief, at least makes it plain that the theoretical explanation of the subject is not the simple process sometimes imagined. The movement of a given tax is not invariably in the same direction: its course will be guided by the surrounding circumstances. Without knowing what these are we cannot tell the direction, much less the precise extent, of its incidence. To pretend to say where, *e.g.* a tax on profits will fall, without possessing further data, is as vain as to seek to determine the space traversed by a moving body whose initial velocity and period of movement are both unknown.

The difficulty of estimating the incidence of taxation is increased by the complementary alterations that take place in the economic system. A change in rent implies changes in the amount and probably in the relations of the other

shares in distribution; a rise or fall in the price of one article leads to other changes of price, and we may therefore expect that even in the most precise and determinate cases of incidence some additional diffused effect will be produced.[1]

At the best, and after the exercise of the utmost care, there will remain some obscurity as to the exact extent to which shifting takes place, owing chiefly to the difficulty of employing statistical verification.[2] Deduction from general propositions cannot overcome this obstacle, and special vigilance is therefore necessary to avoid errors arising from the want of a check such as the process of verification provides. The earlier theories are so many warnings of the danger of hasty deductions from insufficient premises.

But, subject to these cautions, the use of the theory is by no means slight. We may not be able to give confident answers to general questions on the subject, but in dealing with particular instances we shall have the advantage of knowing what conditions we ought to notice and what effects we may reasonably look for. So understood, the theory of incidence is an indispensable part of financial doctrine.

[1] Lord Avebury (*Statistical Journal*, lxiv. 567) regards this statement as 'an admission which amounts almost to a surrender' of the hostile position taken above (§ 4) in regard to the theory of equal diffusion. He fails to perceive the difference between a complicated adjustment and an equal distribution, and has overlooked the explanation of 'diffused incidence' as being 'where the process of shifting affects more than two parties,' *supra*, § 5.

[2] The most elaborate attempts at statistical investigation of the shifting and incidence of a tax is the study of Laspeyres on the effects of the abolition of the Prussian 'meal and meat' tax, *Finanz Archiv*, xviii. 46–282. The results reached are quite in accordance with those obtained by the deductive method.

CHAPTER VI

THE PRINCIPLES OF LOCAL TAXATION

§ 1. BESIDES the system of taxation intended for the support of the central government, and therefore usually described as 'general,' or 'imperial,' the compulsory revenue needed for the due maintenance of local authorities requires to be considered. This latter class of charges is just as much entitled to the name of taxation, and in many respects exhibits the same features, as the imperial tax revenue. Local and central government are simply different forms of the state organisation, and clearly show their fundamental resemblance in their financial systems. The need of revenue, the general characteristics of that revenue in respect to its origin, and the influence that it exerts on individual and national wealth are the same in the case of central and local bodies, and thus it might almost seem that no necessity existed for a separate treatment of the tax receipts of those smaller units that historical circumstances or the needs of social life have called into being.

But, notwithstanding this general similarity, there are certain peculiarities in the methods of local finance that make it desirable to devote a separate chapter to the consideration of the principles that should guide its working. Without in the slightest abandoning the conception of the unity of all taxation, we may examine those aspects of local taxation that give it in some degree a distinct and

special character, and enable us to contrast with advantage the two categories of revenue belonging respectively to supreme and to subordinate political bodies.

One very obvious though rather superficial reason is found in the great magnitude of each class. The British Imperial revenue for 1898–9 was, in round figures, £108,000,000; that for local purposes (excluding loans) was £80,000,000. In other countries there is the same possibility of opposing the two sets of charges without finding any such difference as to warrant us in regarding either as entirely insignificant. When we add that local charges are, on the whole, increasing more rapidly than imperial ones, it is easy to understand the interest that has been excited respecting them.

There are other and deeper reasons. Local institutions have a special function as representing the interest of particular districts; they are confined to a somewhat narrow range of duties, and as a consequence their revenue system is simpler and less involved than that of the State. A rural *commune* must have a comparatively primitive form of financial organisation, and even in the case of the largest subdivisions the absence of military and naval expenditure and the large portion of other public duties discharged by the agents of the central government keep down their requirements. The expenditure of a great municipality or a large American State is no doubt considerable and for very varied objects, but cannot compare in extent or in comprehensiveness with any national budget. Moreover, the restraints imposed on their financial action, either by legislation or (in federal States) by constitutional limitations, are a serious check on the power of local bodies.[1]

Another reason may also be assigned: the subjects with which local administration has to deal are mainly of an

[1] In such governments as England or France the legislature can completely control the fiscal expedients of municipalities and other smaller territorial administrations. The powers of the American 'State' are limited (*a*) by the federal constitution, (*b*) by the state constitution. Cities are controlled by state legislation. Cp. Bryce, *American Commonwealth*, i. 498.

economic character, and very often admit of rather definite measurement. Water-supply, lighting, drainage, and the care of roads are instances. The conduct of such matters, if it has some resemblance to the duties of the national government, has others no less strong to the management of an industrial company. The propositions that 'contributions should be proportional to advantages received,' and that 'political power should depend on the amount contributed,' are much more plausible when applied to local than to general government. The extent of this resemblance will, of course, depend on the special character of the subdivision. A rural parish, or *commune*, is in this respect very different from London or Paris, but the prominence of economic interests in the widest sense is traceable in all forms of subordinate governments.

§ 2. The history of local institutions has already been briefly noticed in connexion with expenditure,[1] and it throws light equally on their receipts. One prominent class of these bodies is really a 'survival' of what were at one time sovereign powers.[2] The 'States' of Germany and America and the 'cantons' of Switzerland are well-known examples. Lower down in the scale the *commune* is the primitive political 'unit' whose importance has decayed with the growth of the State. In all of them the taxing power has been limited by the pressure and competition of the national government, and in the earlier forms by the slow development of taxation. The manor or village community depended on economic revenue not on taxation in the modern sense. One striking feature in state development has been the absorption of the more productive forms of compulsory revenue by the central financial system. It was only natural that the monarchical State, with its hostility to feudalism and to local privileges and immunities of all kinds, should endeavour to take into

[1] See Bk. i. ch. 7, §§ 2 sq.

[2] This is true even of the American colonies in the period between the separation from England and the establishment of the present constitution.

its own hands the customary taxes of districts and municipalities. The centralising movement of the sixteenth and seventeenth centuries was specially noticeable in respect to taxation.

Motives of convenience assisted in promoting this change. Some of the principal forms of revenue were manifestly unsuitable for small territorial divisions. The taxation of commodities or of income was far better fitted for the control of the central government. Thus both political and economic reasons existed for the failure of the older tax revenue of towns and localities.

The existing systems of local administration have in many cases a quite different origin ; instead of being older than the State, they are its direct creation. In France, for example, the whole tax-system of the 'departments' and 'communes' rests on legislation not a century old, and though English institutions have a longer history, they are equally the expression of the State's will.[1] Thus local institutions are not always survivals, or even revivals, of the past ; they are often entirely new formations, devised to satisfy the needs for which devolution of authority has been deemed expedient.

In such instances their power of taxing is a concession strictly limited by the terms of the grant. The adoption of new expedients is precluded, so that very often merely the amount of one particular tax has to be settled, and that only within definitely fixed limits. Local taxation becomes, in fact, a kind of supplement to the general system, admitting of little independent movement. The two opposing tendencies that affect local administration are in full operation here. On the one hand there is the desire of skilled financiers to keep the errors and mistakes of the smaller bodies under supervision. Party spirit and class-interest

[1] The great measures of legislation on local government are (1) The Poor Law Act, 1834; (2) The Corporation Reform Act, 1835; (3) The Local Government Act, 1888, creating County Councils; (4) The Local Government Act, 1894, establishing Parish and District Councils.

are intensified when confined to a small area, and are but too ready to employ taxation as an engine of oppression; and even when no injustice is intended, the ignorance of the real working of taxation that is so common amongst local administrators would, if unchecked, prove disastrous to the national interest. Hence the limitations on the form and amount of taxation as well as on its application. The citizen who is unfairly burdened by his local taxes has as legitimate a claim to relief as if the general charges were too heavy in proportion to his income.

Side by side with this idea of more careful control there is the disposition to extend the sphere of action of local authorities. It is felt that political education is promoted by inducing citizens to manage their common affairs in an independent manner. To awaken or to strengthen the feeling of responsibility is impossible unless power to act is also bestowed. A local body cannot be expected to feel any great interest in its work if all the important parts of the system are predetermined. To secure a vigorous municipal life there must be a good deal of latitude given to the corporations engaged in its management. Wider taxing powers and new forms of local revenue are, therefore, often suggested as indispensable steps in reform. To understand the position of the question, we must bear in mind the existence of these apparently contradictory sentiments, both, in some cases, vehemently held by the same persons.

§ 3. The first step in an examination of the principles of local taxation is the determination of the proper line of division from the general state revenue. We have seen that the distribution of duties between central and local administration conforms on the whole to certain general principles,[1] and the most natural course would be to apportion the charges on a similar system, but, in fact, there is no real correlation between the two: the division of duties is largely independent of the division of taxes, just as

[1] Bk. i. ch. 7, §§ 6, 7, 8.

both are distinct from the distribution of public property and quasi-private receipts. The partition of taxes between the two classes must depend on, or at least be guided by, financial and economic considerations.

Some important taxes are at once on sound principles shut out from use as local resources. The customs are only levied at the national frontier; any attempt to restore the provincial customs boundaries that hampered the trade of France before the Revolution, and in the 19th century that of the German and Italian States, would be a retrograde as well as an unpopular step in finance. The taxation of commodities *in transitu* is only legitimate when exercised in a way calculated to cause the smallest amount of delay and inconvenience. To regulate trade between small areas for fiscal purposes would be at once costly and unproductive, and therefore uneconomical.[1] The earliest step towards federation between independent States has been the abolition of custom-houses at their frontiers, and there is no probability that a reversal of this salutary process will be witnessed. *Octroi* duties are, indeed, an exception, but their continuance can be readily explained. They are confined to towns, and therefore are regulated with comparative ease, having, in fact, some resemblance to the market dues once so common in British towns. They make as near an approach to direct taxes on local consumption as can well be devised, with some additional incidence on the surrounding country through their effect on demand. Besides, they are unquestionably a decaying form. France and Italy are the only countries where they are in full force, and even in these they are looked on as a necessary evil. It is almost certain that in the progress of reform they will ultimately disappear. On the same grounds local excise taxes are practically prohibited. To

[1] The following is curious as coming from a strong supporter of free trade: 'I should be inclined to suggest as a possible means of taxation . . . a customs duty or *octroi* on the admission of articles of general consumption into a locality.' Giffen in *Memoranda*, 98; see also Row-Fogo in *Economic Journal*, xi. 356–7.

impose a duty on an article without having the power of levying an equivalent customs duty would mean the sacrifice of local producers, unless they had a strict monopoly up to the amount of the tax: such a tax would be easily evaded by moving outside the boundary. Thus the great forms of indirect taxation on commodities are withdrawn from the list of local resources. Direct duties on consumption might be used, but, as will appear,[1] they are difficult to manage and only moderately productive.

Income and property taxes are equally unavailable, though for a different reason. Both are essentially personal and apply to a given individual. Now to tax a person on his income for the service of the locality in which he resides is open to the double objection that it is likely to be evaded and is grossly unfair. Local authorities have no efficient machinery for detecting concealed income: they are in a worse position than the English revenue officials in regard to foreign investments, where failure is admitted. The mere moving from the area for part of the year would upset the arrangements. As to unfairness, Lord Goschen's view seems conclusive: 'It appears to be impossible to devise an equitable local income tax, for you cannot localise income. An attempt was made in Scotland, and it broke down when an English Lord Chancellor, who drew his £10,000 a year in London, but had a small place in Scotland, was made to pay income tax on the whole of his income in that country as well as in this.'[2] No real correction could be made without exempting all income earned outside the district, or, in other words, changing the income tax into a partial produce tax. No matter how large the local division may be, the same objection lies. American States and Swiss cantons are as little suited for the application of separate income taxes as England, Ireland, and Scotland. Owing to the variety of modern incomes and the trouble of following them to their sources,

[1] Bk. iv. ch. 5, § 6.

[2] *Local Taxation*, 204.

the income tax should always be general. A property tax is in much the same position in local taxation, though its defects as a part of any tax-system are so great that it is doubtful whether it should be admitted even into the list of good national taxes. It appears to have the two great faults of injustice in distribution and liability to evasion.[1]

The reasons for the removal of taxes on income, property, and commodities from the list of local resources are in a great degree technical, and rest on the difficulties of their fair or economic application. But it is further plain that there must be a large body of productive taxation reserved to the central government. Even if all the taxes mentioned were eminently fitted by their nature to contribute to local revenue, they would have to be kept for the still more important services of the national administration. So much depends on division of duties between the two sets of organs and their relative cost, that it is hardly possible to lay down any general rule on this part of the subject. We may, perhaps, fairly assume that at lowest one-half of the total sum collected in taxes will have to be taken by the central government.

§ 4. On the other hand, there is a different class of taxes well fitted for local treatment. Such are those levied locally on fixed property and permanent occupations carried on in the locality. First in natural order is the land tax. Both abstract reasoning and experience tend to show that a large proportion of local taxation must be obtained from this important 'object.' In rural districts there is little else to be taxed, and in the case of towns the value of land is so much increased by the action of social conditions that it forms a most suitable mark for the larger taxation that the wants of urban societies make necessary. The theory of incidence also supports this view. Other charges are often shifted to rent, while it can hardly ever transfer its peculiar burdens. As a land tax tends to become a tax on

[1] For further discussion of the property tax see Book iv. ch. 4, §§ 3, 4.

rent, and can generally be so regulated as to take that shape, it has definiteness of incidence in its favour ; while its pressure falls on a form of wealth that is likely to grow without effort on its owner's part. The doctrine of taxation in proportion to service, though untenable in general, has here some force. The chief gain of local expenditure accrues to those who own property in the district. Some advantages may be more evident in their effects than others, but in a broad general way the advance of a locality means an advance in the rent of its area. There are, no doubt, exceptions : unfortunate proprietors have sometimes had to pay for 'improvements' that lowered the value of their land,[1] but on the whole the opposite effect is more common.

Next to the land tax we may place the house tax as a convenient form of local impost. It is, indeed, somewhat more complicated in its operation ; its incidence, which by regarding houses as a particular manufactured commodity, would appear to be on the occupier, really varies according to the method of imposition and the particular local conditions, and it has the disadvantage of affecting one of the most important elements of necessary expense,[2] but on the other hand it is easily collected, tolerably proportional to income, and does not touch those unconnected with the district. If houses are to be taxed the revenue thence derived should, we believe, go to local, not to general revenue. The same reasons that have been noticed in the case of land apply, though with less force, to that of houses. This form of property gains in value by expenditure, but it also deteriorates through use, and therefore the indeterminate portion of the tax that falls on the house-owner should be kept within moderate bounds.

A third form of local taxation is discovered in the taxes on the exercise of occupations known as 'licenses.' These are better suited for local than for general taxation.

[1] Cp. Report of Town Holdings Committee (1891), Questions 176–180.

[2] See Bk. iv. ch. 2, § 5, for a discussion of the incidence of house taxes.

They can be readily collected, and, if properly chosen, do not hamper industry. The system of low license duties on most trades and employments has the chief attributes of a fair local tax. The English method of appropriating the spirit licenses to the local bodies might with advantage be further developed.

Very similar in outward appearance are the licenses for direct enjoyments, and, though they differ in their essential character, they also may without impropriety be assigned to the several localities.[1] Certain difficulties do indeed arise in this connexion. A license taken out in one place may be required for use elsewhere, or may even be exercised in several different localities. In practice the right of transfer may be allowed, or, better still, such cases may be reserved for the central revenue, leaving only the localised privileges to the smaller bodies. As a further resource, some of the taxes on acts may be usefully employed by localities. Thus the transfer of property, registration of companies, and other charges on legal transactions would provide a fund for the payment of the expenses connected with these administrative functions. Those taxes that closely resemble fees will come under the same rule as to their division.[2] Each administration will retain for itself what it collects.

The foregoing suggested distribution must necessarily be modified to suit the needs of particular financial systems. Thus the house tax forms a part of general taxation in several countries: its complete surrender to the local authorities when proposed in England was made contingent on the position of imperial finance, and has not yet been carried out.[3] We can hardly imagine the Indian Govern-

[1] The *Final Report* of the Royal Commission on Local Taxation recommends the transfer of 'licenses' to the local authorities.

[2] Bk. ii. ch. 5, § 3.

[3] Goschen, *Local Taxation*, 205: 'It may happen that owing to events at present unforeseen, it will be impossible for the Imperial Exchequer to part with so important a source of revenue as the house tax.' The Majority Report of the Local Taxation Commission approves of the surrender.

ment yielding up the land revenue to the provinces. The line of division has to be varied, but it is nevertheless well to know the general principles that should assist in determining it.

§ 5. But given the partition of revenue between the two forms, we have next to see whether the rule of justice that we accepted for general taxation can be applied without reservation in local finance. Taxation in proportion to income gives a substantially just division of general burdens, but in the case of smaller districts the burden is not a general one. Many important local services are specific, and can be dealt with on the rule of payment for benefit received. A large part of the so-called English 'rates,' such as those for water supply, lighting, cleaning, drainage, &c., may be best measured for each payer by the advantage, or rather the quantity of the service. The citizen, in fact, pays for the supply of certain useful commodities. The local authority is performing a strictly economic duty. Taxation so far should be in proportion to advantage. Difficulties, however, soon arise in the attempt to apply this principle. In addition to the direct service rendered there is a margin of advantage accruing to the whole society, some of the service is not done for specified persons and some of the duties of local governments are of national advantage. The necessity of investing capital, the repayment of which is spread over a long period, complicates the case. To get a fair division of the charge between owners of land, possessors of fixed capital, including houses and the immediate users of these public services, is no easy task. It involves (1) a determination of the real incidence of the different modes of taxation, and of the extent and rapidity of the process of shifting; (2) an estimation of the truly equitable division between the several interests; and (3) a full recognition of the practical limits that any effective system must observe.

As regards the first head the general principles of incidence have to be considered, but the special incidence of

land, house, and capital taxes are of particular importance. For convenience we may here so far repeat and anticipate the result elsewhere stated.[1] The immediate consumer, *i.e.* the occupier of a house, or the user of other taxed convenience, looks on local taxation as simply a part of the price of the utilities he receives. So far as the outlay benefits him directly, he bears it as payment for increased advantage, and taxation is only shifted by him when the sacrifice it imposes reduces demand; heavy local taxation, unaccompanied by corresponding increase in utility, tends to diminish demand for the services so charged, and gives a backward shifting on the producers, *i.e.* the house-owners or other holders of the articles. The check to these particular forms of industry will ultimately reduce the capital and labour employed in them, and thereby pass the pressure on to the landowners in the shape of lowered ground rents so far as land entered into the supply of services. Such seems to be the process by which the 'orthodox' views on the incidence of rates were reached, the burden being ultimately distributed between the owner of land and the consumer. In respect to taxes on agricultural tenants, the same train of reasoning suggests that the incidence is ultimately on the landlords, as outside competition hinders any forward movement to the consumer of produce.[2] It is hardly necessary to say that this doctrine assumes a uniformity in the course of shifting that has no real existence, since it omits some circumstances that are essential elements in the problem. Amongst these are: the long duration of the arrangements between owners of land and of capital; the position of qualified monopoly that owners of land in towns possess,

[1] See Bk. iii. ch. 5, §§ 5, 6, 7; Bk. iv. ch. 1, § 9; ch. 2, § 5.

[2] On the question of incidence see Goschen, *Local Taxation*, 163–168, and the *fifth* Report of the Committee on Town Holdings, No. 341 (1890), especially Questions 41–5, 88–101, 331 (Sidney Webb); 1804–32, 2024–26 (Munro); 1243–46 (Farrer); 2714–22 (Rogers). The *Memoranda on Classification and Incidence*, issued by the Local Taxation Commission, contain the latest views on this important matter, see also 'The Incidence of Urban Rates,' Edgeworth, *Economic Journal*, x. 172 sq.; 340 sq.; 487 sq.

and which with its advantages has the disadvantage of exposing them to the action of shifting; the slowness with which adjustments are made, which hinders much reliance in matters of legislation being placed on the operations of shifting in securing a proper division of the burdens.

The second head, that respecting the true interpretation of the rule of just taxation, is made more difficult by the complicated interests, some present, some future, that modern society is ever creating. In apportioning taxation between occupier, house owner, and ground landlord, we may discover that each of the two latter interests is divided into three or four parts, all in equity bound to share in the burden for the common advantage. Still greater difficulty is caused by the manifold duties of local government, some of which are merely delegated for convenience, not because they are solely of local interest. Police, prisons, poor-relief and education may be cited as examples. We cannot with any reason maintain that owners, whether of land or other property, and ordinary householders, are alone interested in the efficient management of these important matters. The policy of defraying all these charges out of particular funds with the practical exemption of others no less liable is a grave injustice. The cost of expenditure that is in essence for general purposes should follow the same distribution as that of general taxation.[1]

Thus the rule of taxing according to interest affected is not a complete and absolute principle for the distribution of

[1] The distinction drawn in the text between expenditure for general purposes and that for the particular advantage of the locality has been well expressed in recent discussion by describing rates levied for the former as 'onerous,' those for the latter being 'beneficial.' The serviceable terms, which seem to have been first applied in this connexion by Sir G. H. Murray (*Economic Journal*, iii. 701), are employed in the Reports of the Royal Commission on Local Taxation and are best used with direct reference to expenditure. It should be added that the distinction between the two classes has been long recognised by scientific students; cp. *e.g.* 'Da die Gemeindewirthschaft in so vielen Punkten eine Art von Mittelstellung zwischen Staats- und Privatwirthschaft einnimmt, so darf man auch bei ihren Steuern nicht vergessen dass zwar manche ihren Ausgaben nur decentraliserte Staatsleistungen betreffen,' Roscher, 159. Cp. also Cohn, §§ 125–6, and 459.

local finance. Certain forms of direct public services can be so dealt with. Another portion may be fairly placed on the owners of durable property, as those who benefit most by an active and judicious local administration. A third and not inconsiderable share may be levied from the community generally by the agency of local licenses and taxes on transactions, and still more by a tax proportional to house rent, which is a good rough measure of taxable capacity.[1]

§ 6. The especially economic character of local administration is particularly noticeable in its direct effect on the value of portions of private property situated within its jurisdiction. The opening of a new street or the removal of insanitary buildings may add greatly to the utility and even the selling price or rent of adjacent property, and the fortunate owner discovers that his wealth is increased by the action and at the expense of the local governing body. Here there is at all events a seeming unfairness. It may be plausibly urged that where there is special gain there should also be special contribution. When property is improved, or, in current language, 'bettered,' there is some reason in calling on the owner to pay a part of the cost of that improvement, as otherwise the rule of just distribution of the burden would be violated. Notwithstanding the very plain and simple reasons which would appear to dictate this method of providing some of the revenue necessary for important improvements, it is noteworthy that there are very few traces in Europe of any such expedient.[2] It has been reserved for the state legislatures of the American Union to give it a wide development under the title of 'special assessments,'[3] by which a special charge

[1] 'It is one of the fairest and most unobjectionable of all taxes. No part of a person's expenditure is a better criterion of his means, or bears on the whole more nearly the same proportion to them.' Mill, *Principles*, Bk. v. ch. 3, § 6. Supported by Engel's researches.

[2] See Rosewater, *Special Assessments*, 2–21, for instances.

[3] Rosewater, *ib.* chs. 2, 3. It may be added that the rapid growth of towns in America made this system almost necessary. Owners of property hardly felt aggrieved when they really got full value for the charge. Though they

is imposed on property that has gained through municipal action. The particular machinery by which the amount of the assessment is determined varies from state to state (and even from town to town), and need not be considered here; but the general principle deserves some consideration. On the one hand there is very strong ground for believing that where outlay is incurred for the advantage of a limited class of owners they may justly be required to pay for the peculiar advantage that they have obtained. Besides, there can be little doubt that the wide use of special assessments makes the work of improvement easier. The ordinary ratepayer will not feel the same hostility that he does at present to costly but necessary alterations. But on the other hand these very advantages suggest some serious objections. The local administrators and the owners of the 'bettered' property may form widely different estimates as to the value of the improvements in question, and in such cases the latter will not always be mistaken. Again, the relief given to the general ratepayer is not wholly beneficial; it tends to weaken his vigilance—at best not very keen—in respect to unprofitable schemes, and to foster the undesirable feeling that the voters should support extensive municipal works, leaving part of the bill to be paid by a limited, and perhaps politically powerless, class. Rigid limitation as to the share of cost to be assessed on the owners[1] will greatly reduce, but cannot altogether remove, this evil. A further difficulty arises in connexion with the fixing of the properties to be assessed, and the amount of 'betterment' given to each. To attain any satisfactory result a careful judicial inquiry before a competent and impartial tribunal is an essential condition. On the whole, it seems most in accordance with the evidence to conclude that the employment of special assessments, while justifiable in principle, and in some important instances desirable,

did not contract with the municipal authorities (as not seldom happens in Great Britain), there was in fact a quasi-contract, which saved trouble.

[1] For the provisions in various American towns see Rosewater, 64-65.

needs to be carefully controlled; the proof of benefit bestowed must be very clear and well established, and the amount diffused over the general community, and therefore, even on the strict 'benefits' principle, payable from the rates, must be taken into account. With the observance of such precautions it is possible to secure a contribution out of the fund created by the direct action of the local government, and at the same time to avoid unfair pressure on individuals.[1]

§ 7. After all these different expedients have been carried as far as circumstances will allow, it may be necessary to readjust the balance between the central and local governments, either (1) by a transfer from the funds of the former in the shape of (*a*) payments for certain services, or (*b*) assignment of revenue, or (2) by the employment of its taxes as a base on which to raise additional local resources. Most financial systems have adopted one or both of these expedients. To begin at home: Complaints as to the pressure of local burdens led by degrees to payments from the central government for various services that appeared to be of a general character. This process began in 1835 by small payments in connexion with criminal administration. It was later on applied to the support of the police force, and gradually extended to other services, until in 1885–6 the total amount came to £5,775,523.[2] The objections to this hap-hazard system were obvious. Additional grants were made to buy off opposition in Parlia-

[1] Special assessments in the United States represent a capital sum; but as they can be collected by instalments this is really non-essential. Either a fixed rate extending over a number of years, sufficient to pay off the principal expense, funds for which could be obtained by borrowing (cp. Bk. v. ch. 8), or redeemable rent charges seem to be the best technical forms.

[2] See the history lucidly given in Sir E. W. Hamilton's 'Memorandum' (C. 9528), reproduced in *Memoranda*, 11–19; also Chapman, *Local Government and State Aid*, ch. 7. Each of these 'grants in aid' was clearly due to 'the pressure brought to bear on the government' by interested parties, as, indeed, Sir E. W. Hamilton's narrative shows. One important item is the cost of the Irish police, which exceeded £1,408,000 in 1895–6, and is still paid by the central government.

ment and were always arranged on the basis of a compromise. The Imperial Exchequer was burdened and there was confusion between the two classes of revenue and expenditure, as what was outlay on one side was income on the other, the same sums being counted twice over. Accordingly the extensive reform of local government by the establishment of County Councils in 1888 was accompanied by a change in the relations of the Exchequer to local finance. The Grants-in-Aid were, speaking broadly, abolished, and a separate local taxation account created to which certain portions of the central revenue were assigned.[1] The aim of this reform was to secure the complete separation of local from central finance, thereby restoring simplicity to the national budget, and also to prevent the further demands on the part of the localities, while by the assignment of a part of the Probate Duty the alleged unequal treatment of real property was at least reduced.[2] Unfortunately the new scheme was imperfectly carried out, and the old policy of grants was revived in a new form. The large grant in relief of rates on agricultural land, introduced by the Act of 1896 and extended to Ireland by the Local Government Act of 1898,[3] placed an annual burden on the Exchequer of over £2,200,000. A further difficulty arose in the distribution of the funds assigned to the local taxation account. As the automatic rule of payment in proportion to expenditure or efficiency had been abandoned, it became necessary to take some arbitrary basis of distribution, which must from

[1] These were (1) the license duties; (2) a proportion (one-half) of the probate duty; (3) 6*d.* per gallon on spirits and 3*d.* per barrel on beer, *i.e.* taxes on acts, property, and commodities. In 1894 a portion of the new estate duty equivalent to the previous probate duty was substituted for the latter.

[2] See Final Report of Commission on Local Taxation, 'The principles on which Mr. Goschen's scheme was founded are in our opinion broad and sound.' 17; cp. 112. For a more unfavourable view see Farrer, *Mr. Goschen's Finance*, 80 sq.

[3] English Agricultural Grant £1,340,000
Scotch ,, ,, 185,000
Irish ,, ,, 730,000

the nature of the case be unsatisfactory.[1] There is an entire absence of equity in the actual system of distribution, either as between localities, or between the several countries that make up the United Kingdom. The effect of these contributions on local finance was not encouraging to either economy or administrative efficiency. Finally, so far from improving the form of the public accounts, the system of assigned revenues has made budget statements more complicated, and has, to some extent, obscured the real growth of important branches of revenue.[2] Still, on weighing the two systems, there is a slight balance of advantage in favour of the assignment of revenue, provided (*a*) that suitable taxes are selected, and (*b*) that the true relations of local and central finance are properly explained.

An analogous policy has been pursued in Belgium, where the *octrois* were removed in 1860 and replaced by parts of several indirect taxes.[3] Prussia has also used the system of subventions.[4] This method receives an extension by making the local taxes merely additions to the general ones. Thus the French *communes* and departments draw important tax revenues from the '*Centimes additionnels*,' *i.e.* charges added to the four direct contributions. The same plan has been used in the German States and Austria

[1] See the vigorous criticism by Hamilton and Murray in their separate Report, Local Taxation Commission, *Final Report*, 116–120; and Chapman, *Local Government*, ch. 8.

[2] It has been alleged that 'ear-marking' of certain sources of revenue for the local taxation account is a mere fiction, since, whatever funds may be assigned, it is necessary to impose fresh or retain existing taxation to meet the gap in the national revenue, and it is this fresh (or retained) taxation that goes to the aid of local finance. This is true, but it is equally true of the transfer of any form of taxation, owing to the fact that imperial and local finance are essentially connected. The revenue system is fluid, and the ultimate adjustment always operates on the 'marginal' expenditure and the 'marginal' revenue. See Bk. i, ch. 8, § 4.

[3] 75 per cent. of the coffee duty, 25 per cent. of the spirit duties, the excises on sugar and wine, and 40 per cent. of the postal receipts. See De Parieu, iv. 386 sq. for a full discussion.

[4] Particularly by the Lex Huene of 1885, repealed in 1893; see 'Die Lex Huene . . . und ihre Wirkungen.' *Finanz Archiv*, x. 488–498.

though under the reforms of the 'Miquel' laws independent communal taxes are now developed in Prussia.[1]

Some high authorities approve of this policy of making local taxation a mere appendage to general taxation. 'It is rightly asserted,' says Leroy-Beaulieu, 'that the French system of movable additional charges on the existing direct contributions, of uniform accountability, and the collection of direct local taxes by the agents of the State, makes the management of local finance simpler, clearer, and less costly, and gives the taxpayers much greater security against peculation and exaction. We do not hesitate for our part to declare for that system.'[2] But notwithstanding this weighty judgment we are forced to believe that there is an advantage in having a separate system of local taxation. The aims of the two classes are so different and the rule of distribution varies so much, that a decided boundary between them is rather desirable. Both will naturally avail themselves of such material and agencies in the shape of valuations and officials as exist, but this does not necessitate the treatment of local taxes as merely added percentages to established general taxes. The success of local government depends on the energy and vigour with which it is worked, not on restraining its action within the narrowest limits. 'The ideal condition of finance in a perfect system of local self-government' has been described as 'one in which each local authority levies its own taxes upon its own subjects within its own area; in which it has the power of applying the proceeds of these taxes within certain limits fixed by

[1] i. 712. Mr. O'Meara—*Municipal Taxation*, ch. 5—pronounces in favour of the Continental system of *Centimes additionnels*, but the much higher authority of Mr. Blunden may be cited in support of the position in the text. *Local Taxation and Finance*, 72. The Prussian reform which practically abandoned the system of *Zuschläge*, except in the case of the income tax, also supports it.

[2] For a detailed account of Prussian local finance and the recent changes therein, see Wagner, iv. 64-97; also 'Local Government and Finance in Prussia,' *Diplomatic and Consular Report*, No. 487 (year 1899), and J. Rowfogo, 'Local Taxation in Germany,' in *Economic Journal*, xi. 354-78. The last-named writer seems to have in some way misunderstood the brief statement in the text, which is in accordance with the facts.

the general law, for the local advantage of its own citizens; and in which it has power to increase or diminish its taxes at its own discretion, according to its means and its wants.'[1] The benefits of fiscal autonomy may perhaps not be so great as in certain conditions to compensate for the want of the harmony and regularity that state intervention secures; they are, however, sufficient, in conjunction with the reasons already given, to justify strenuous efforts for securing a distinct tax-system, and this is possible without any sacrifice of the guarantees for good government.[2] At the same time we may fully recognise the convenience of supplementing local revenue from general taxation with the double object of securing adequate funds and more equitable distribution of burdens, though, while granting this, we must also insist that the extent to which the process is applied ought to be confined within the narrowest limits consistent with attaining the end in view. The allotment of part of the taxation available to meet the general expenditure is a measure that always stands in need of justification; it has a presumption against it which must be rebutted by sufficient evidence.[3]

§ 8. The relations of local and general finance suggest another closely related point, viz. the extent of the fiscal liberty to be bestowed on the local financial powers. Be-

[1] Farrer, *Mr. Goschen's Finance*, 54.

[2] Mr. Row-Fogo (*Economic Journal*, xi. 355) refers to the text, and confesses himself 'entirely unable to appreciate the weight of this argument,' which is natural enough, as he has misconceived its meaning. The question is not one of 'making up the roll.' The real point is the amount of discretion given.

[3] The various Reports made by the Commission on Local Taxation agree in recommending additional aid from the central Government to local finance. The chief feature of difference is respecting the form of the relief. The proposal of a definite grant from the Consolidated Fund, adjusted at intervals of ten years, and equal to one-half of the 'onerous' expenditure (see *supra*, § 5), is strongly urged in the separate Report of Sir E. W. Hamilton and Sir G. Murray. The *crux* of such schemes is the discovery of a just method of distribution. The plans suggested for this purpose seem to involve a series of arithmetical calculations resting on no solid basis of equity. See *Final Report* [Cd. 638], 23–32, 73–83, 133–140.

tween the extremes of complete regulation and almost complete independence we may discover a series of steps corresponding to the size of the bodies and the political training of the people. The national government may fix the particular taxes and their amount, or it may, as with the French *communes*, let the latter be varied if its permission is sought. Again, it may lay down the forms of taxation and place bounds to its amount, either definitely determined or variable. Or, finally, the duty both of selecting the taxes and determining their amount may be given up to the local government. The first mode means the reduction of the local authority to impotence so far as taxation is concerned; it simply executes the Sovereign's orders. The other extreme approaches closely to independence. The taxing power is always an attribute of sovereignty: a body that had full taxing power would have got very near that position. Accordingly, we find that the customs duties in all Federal States come under the control of the central government. The extent to which the right of independent taxation has been restrained is a mark of the progress of the State towards unity. Co-ordinate fiscal authorities have to be kept within bounds by constitutional rules, but we may safely conclude that in a durable State the supreme power in financial matters will sooner or later be vested in the central government.

The extent to which the liberty of experiments in taxation should be conceded to the subordinate bodies must, we believe, be carefully limited. For the smaller units the taxes should be absolutely laid down, and also the maximum to be raised, but the opportunity of economy should not be denied them on the condition that they duly discharge their necessary functions.[1] The larger circumscriptions are fairly entitled to greater latitude. A higher standard of intelligence may be expected from their representatives, and their economic resources are more varied. But even with them the need for supervision cannot be said

[1] Bk. i. ch. 7, § 9, for these duties.

to be absent. They may impose taxes that press heavily on unpopular sections in their district; they may deal unjustly or ignorantly with important economic and social interests, or they may go counter to the financial policy of the State. For these reasons the unitary form of government is in its financial aspects superior to the federal one, even though the larger liberty of levying new varieties of taxation is a certain advantage in the latter.

CHAPTER VII

THE CANONS OF TAXATION

§ 1. In the general survey of the problems of taxation contained in the preceding chapters of the present book, we have implicity given the rules that should govern the management of this part of state revenue. The mere statement of a general maxim is of little use unless its real bearing and its actual value are realised by acquaintance with the facts of taxation as shown by history and present fiscal practice. It may even reduce to a dead formula what should be rather a matter of vivid experience. But it must at the same time be allowed that the condensation of results into the precise shape of general canons may prove of service to the theoretic student by enabling him to estimate exactly the effect to be ascribed to the conclusions that critical examination of the revenue system has tended to establish. And such a course, we may add, has been almost invariably followed by writers on finance, who have devoted their best efforts to the framing of rules which should be regarded as imperatively binding on the statesman and administrator. High support may therefore be claimed for an attempt to exhibit in a stricter form the results that emerged from our previous inquiry, even though no special authority can be ascribed to the particular shape in which generally recognised principles will be formulated.

§ 2. When finance was regarded as purely a matter of practice, it was natural that those concerned with the

collection and disbursement of the public revenue should have felt the advisability of framing general rules by which to guide their mode of procedure. Unfortunately the limited view taken by the earlier administrators as to their proper function, which led them to consider almost exclusively the immediate returns obtained, the prevalent ignorance of economic principles, and the immature condition of the state economy, all combined to hinder the establishment of even sound empirical rules. The most famous financiers of so relatively modern a period as the seventeenth century—Sully and Colbert—have left little material of this kind. It is rather by theorists or officials of speculative tastes that the earliest canons of taxation have been produced.[1] The students of economics and finance in the eighteenth century supplied the first really meritorious collection of general rules. In Germany, Italy, and France we find instances of very varying merit, but all affording evidence that the time for the enunciation of maxims had come.

Amongst the more remarkable rules are those propounded by Vauban, Justi, and Verri, partly on account of the reputation of their authors, but also for their indication of the really important points. Nevertheless they can at present only lay claim to importance on historical grounds.[2] The physiocratic maxims were vitiated by the undue prominence given in their system to the rent of land as the sole net product, and therefore the only source of taxation. This fundamental error prevented the great French school from leaving a durable heritage in this respect to their successors.[3]

[1] Mr. Hewins mentions Milles, a commissioner of customs, as advocating 'certainty' and 'indifference of assessment' in respect to taxation of commodities. *English Trade and Finance*, xviii.

[2] For the maxims of the writers mentioned in the text see Vauban (ed. Daire), 47; Roscher, § 44, note 1; Garnier, 324. For Verri see Ricca-Salerno, *Dottrine Finanziarie in Italia*, 276–282.

[3] Quesnay's maxims have been already referred to: *Int.* ch. 2, § 6. Those of the elder Mirabeau are to be found in his *Théorie de l'Impôt*, 201, and are also given by Roscher *ut supra*, and by Garnier, 325.

§ 3. Very different is the position occupied by Adam Smith. The maxims inseparably associated with his name[1] were in his own day accepted by theorists and statesmen, and have by constant repetition become an indispensable part of any exposition of finance. Though fully in harmony with the spirit of the 18th century, they have not been found inapplicable to modern conditions, and in spite of much hostile criticism bid fair to hold their ground in the future.[2]

These famous maxims—to once more repeat them—are four in number, and run as follows:

(1) 'The subjects of every State ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities—that is, in proportion to the revenue which they respectively enjoy under the protection of the State.'

(2) 'The tax which each individual is bound to pay ought to be certain and not arbitrary. The form of payment, the manner of payment, the quantity to be paid ought all to be clear and plain to the contributor and to every other person.'

(3) 'Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it.'

(4) 'Every tax ought to be so contrived as both to take

[1] Thorold Rogers speaks of 'The famous canons of taxation which Adam Smith borrowed from Turgot' (*Economic Interpretation*, 115), but gives no evidence in support of his statement, which is clearly unfounded. On the interesting question of Smith's relation to Turgot, see Léon Say, *Turgot*, 45; Rae, *Life of Adam Smith*, 203 sq. Cannan, Introduction to Adam Smith's *Lectures*, pp. xxiii–xxiv. According to Cunningham, 'Adam Smith's celebrated maxims about taxation are improved in form, but in substance' are adopted from Moreau de Beaumont. *English Industry and Commerce*, ii. 436 n.

[2] The prevailing sentiment of his time is conveyed by J. S. Mill when he calls the Smithian maxims 'classical.' The extreme limit of hostile criticism is reached by F. A. Walker, who declares that 'These maxims have been quoted over and over again as if they contained truths of great moment, yet if one examines them he finds them at the best trivial, while the first and most famous cannot be subjected to the slightest test without going all to pieces.' *Political Economy*, 489. Cohn's judgment is quite as severe. § 333.

out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the State.'[1]

One obvious comment on these rules is that which notes a difference between the first canon and the remaining ones. The former is a rule of taxation; the latter are rules respecting taxes. The first canon is therefore applicable only to the tax-system, as a whole, while the second, third, and fourth should be observed in the case of each separate tax. Mill, therefore, has some justification when he declares that they belong to 'the discussion of particular taxes,'[2] since every tax must be separately tested by them, though of course this circumstance does not remove them from the category of general rules.

Another feature that has been often noticed is the mixture of different classes of considerations. Thus they have been described as 'partly ethical . . . and partly economical in the strict sense';[3] and it seems unquestionable that the second has chiefly a constitutional significance, as prescribing the taxpayer's immunity from arbitrary exactions, but more generally the three last may be regarded with Wagner as administrative precepts.'[4]

This attempt to separate the Smithian rules according to their character, though in appearance plausible, tends to obscure their really compound basis. The first maxim is, it may be said, undoubtedly ethical, since it refers to the justice of taxation. Granting this, it should also be remembered that inequality in taxation diminishes its productiveness and impairs industrial energy; and so viewed, the canon is an economic one. Violations of the rule of equal treatment are, again, offences against constitutional liberty quite as much as absence of certainty. In like manner each of the remaining rules has an economic side; the certainty, the convenience, and the economy of taxation, like

[1] *Wealth of Nations*, 347–8. [2] *Principles*, Bk. v. ch. 2, § 1.
[3] Nicholson, note 45 to *Wealth of Nations*, 418.
[4] Wagner, ii. 292; cp. Sidgwick, *Political Economy*, Bk. iii. ch. 8, § 6.

its equality, are highly promotive of a well-filled treasury and a prosperous industrial system. The true point of view for understanding these maxims is to regard them not as economic, ethical, or constitutional, but as essentially financial; they therefore rightly combine the different elements that must enter into problems connected with that subject.

With reference to the first maxim, it is plain that Adam Smith regarded revenue as the index of ability to contribute, and it may be conjectured that the words 'under the protection of the State,' regarded by Walker as either irrelevant or inconsistent, refer to the case of persons having property in different countries, and therefore imply a prohibition of double taxation.[1] For it must be remembered that international problems were much more prominent in the thought of Adam Smith and his contemporaries than is usually supposed.[2]

§ 4. One natural consequence of the lofty position given to the Smithian canons is the depreciation of rules formulated by other writers. Variations of, or additions to, the four established maxims were regarded as peculiarities or vagaries of the propounder, which, if noticed at all, were rightly to be placed in a very subordinate situation. Nor, indeed, was there anything very novel in the formal contributions made by the successors of Adam Smith. Perhaps the most noticeable exception is that of the eminent historian Sismondi, who, beginning his career as a rigidly orthodox economist, showed in his latter work tendencies of a very different character.[3] But his revolt did not extend to the subject of finance. Like, and probably in imitation

[1] F. A. Walker, *Political Economy*, 490. See also Bk. iii. ch. 3, § 14, and the words there referred to for the discussion of double taxation.

[2] Cp. the questions discussed by the Physiocrats and Adam Smith, respecting the effect of Dutch taxation on France and Germany, and the movement of capital in order to escape taxation. Bk. iii. ch. 5, §§ 2, 7.

[3] *Nouveaux Principes d'Économie Politique*, 2 vols. 1819 (2nd ed. 1827). For Sismondi's general position see Ingram, *History of Political Economy*, 165 sq.; also Roscher, *Geschichte*. 845; and Cohn, *Grundlegung*, § 85.

of, Adam Smith, he prescribes four rules dealing with other points than those already covered by the accepted maxims. He asserts (1) that every tax should fall on revenue, not on capital; (2) that in the assessment of taxation gross produce should not be confounded with revenue; (3) that taxation should never touch what is necessary for the existence of the contributor; and (4), that taxation should not put to flight the wealth which it strikes.

The mere statement of these rules suffices to show their substantial accordance with the ideas of Bentham and Ricardo.[1] They are evidently intended to carry out the principles of saving capital from taxation, of confining the area of imposition to net revenue, and of relieving those who only possess the physical minimum of existence. Though not as fundamental as the rules given by Adam Smith, they yet, taken together, make no inconsiderable addition to the prescriptions of practical finance, even if, as we have seen, it is not always possible to secure their complete observance.[2]

Other expositions may be passed over with still slighter notice. Of French writers Garnier, with a formidable list of sixteen rules—twelve general and four special—is the most elaborate,[3] and also probably the most confused. Among the Germans of the older school Von Hock of, the later writers Held and Wagner, are most important.[4] The last-named in his elaborate examination groups his canons under different heads according to what he regards as their primary character, a course which, whatever be its disadvantages, enables him to lay special emphasis on the purely financial

[1] See Ricardo, *Works*, 87–9; Bentham, *Theory of Legislation*, 107–8; also cp. Bk. iii. ch. 2, § 5, and ch. 3, § 10.

[2] See passages referred to in preceding note.

[3] These are given at length in his *Traité* (ch. 13), 156–165.

[4] According to Hock taxation should be (1) just, (2) logical, (3) economical. Held lays down the rules of (1) generality, or that all who have incomes should contribute; (2) equality, *i.e.* income should be taxed without reference to its source; (3) the greatest possible care of the national well-being and its increase. *Einkommensteuer*, 121.

element.[1] But in truth the whole tendency of modern German financial study has been rather towards description and analysis than the formulation of rules of supposed universal validity. Thus Wagner, while stating his elaborate canons (*Grundsätze*), takes the utmost pains to insist on the need for careful discrimination in each particular case.[2]

§ 5. The foregoing survey of the most prominent attempts to supply a series of precepts gives sufficient material for selection. It is only necessary to place in their proper order and connect with each other the rules that seem to possess the generality and weight required for inclusion in the list. First and most important of the principles that should guide the practical financier is that which declares that 'taxation should be productive.' The very object for which the revenue system exists is to provide for the maintenance of the State, and therefore the minister in charge of the finances naturally estimates the merits of a tax by the amount of its yield. Other considerations will no doubt occur to him, but this is after all the one that can never be neglected. And it is on this point that the amateur in such matters is most likely to fail; he will be attracted by the equity, popularity, or some other pleasing feature of imposts which nevertheless want this primary quality. It is here, too, that the masters of finance

[1] Wagner divides the chief principles (*oberste Grundsätze*) into four classes, arranged in the order of their importance, and distinguished as (*a*) financial, (*b*) economic, (*c*) ethical, (*d*) administrative. Under (*a*) come (1) taxation should be adequate to meet expenditure, (2) it should be elastic; under (*b*) are placed (3) the sources of taxation should be rightly chosen, (4) the kinds of taxes should be selected with reference to their effects; class (*c*) includes rules (5) taxation should be general, and (6) it should be proportional; while, finally, class (*d*) contains the rules that taxation should be (7) determinate, (8) convenient, and (9) collected with the smallest cost, in fact Adam Smith's last three maxims.

The economic rules are somewhat vaguely expressed, but (3) refers to the taxation of income and of capital, and (4) draws attention to the incidence of taxation. The sixth rule is regarded as varying according to the conception taken; from the pure financial point of view it is proportionality to income, from the politico-social one it is in proportion to capacity.

[2] 'Hier muss die Finanzwissenschaft vielmehr specialisiren und casuistisch verfahren, als sie bisher gewöhnlich gethan hat,' ii. 305.

have won their greatest triumphs. To keep steadily in view the idea of productiveness, and select the objects most suitable for that purpose, requires firmness, as well as wide and accurate information.

Next in value we should place the rule that 'taxation should be economical'—and this, as we have seen,[1] includes much more than mere saving in the cost of collection. Undue outlay on the official machinery of levy is but one part of the loss that taxation may inflict. It is a far greater evil to hinder the normal growth of industry and commerce, and therefore to check the growth of the fund from which future taxation is to come. Thus the rule of 'economy' is naturally subdivided into two parts, viz. (*a*) 'taxation should be inexpensive in collection,' and (*b*) 'taxation should retard as little as possible the growth of wealth.' It may also be remarked that there is a close connexion between 'economy' and 'productivity,' since the former aids in securing the latter.

Our third rule is no other than the famous one that 'taxation should be justly distributed,' a vague and plastic proposition, which we may further explain by the interpretation that it should be measured by the comparative abilities of the contributors, and this again may be taken in general to mean 'taxation in proportion to income.' The many explanations that such a maxim requires have been already given and need not be repeated.[2] But here we may add that so far as the 'benefits' or 'service' principle is applied, it excludes the rule of taxation according to ability.

'That the tax system should be elastic' is a further canon, the observance of which is very desirable. It may, indeed, be regarded as the agency for realising at once 'productivity' and 'economy.' Where the public revenue does not admit of easy expansion or reduction according to the growth or decline of expenditure, there are sure to be financial troubles.[3] For this purpose some important

[1] Bk. iii. ch. 2, § 4. [2] See Bk. iii. ch. 3 *passim*.

[3] The experiences of the United States Treasury since the Civil War may be

taxes will have to be levied at varying rates. In the British system the income tax is selected to perform this service ; but some article of general consumption might be placed under a sliding scale duty for the same reason. The particular taxes chosen will vary according to circumstances, but the general principle of flexibility should be recognised and adopted.

Of high importance in earlier times, but now requiring less emphasis owing to its general observance, is the canon that 'taxation should be certain.' When arbitrary power was able to alter imposts at its will, the uncertainty connected with the demands of the tax-collector was a great aggravation of the evil of the heavy burdens imposed. That the citizen in his dealings with public officials should be under the rule of settled law, not of caprice, is not only a financial but an important constitutional maxim.

Regarded from a somewhat different standpoint, the rule of 'certainty' or 'stability' is one that still needs enforcement. Frequent changes in the tax system have a disturbing effect. The economic arrangements of society are adjusted to the actual state of things, and reasonable expectations are formed, which are disappointed by sudden and unforeseen changes. Hence the strong objection that business men feel to even beneficial tariff changes, though the rule of stability is of comparatively little weight in the case of taxes on commodities. But where, as in the case of a long-established charge, such as the French land tax or the English local rates, contracts for lengthened periods have been concluded in the belief that the existing arrangements are permanent, then so-called reform is often a violation of security. It is in relation to this rule of stability that the popular maxim 'an old tax is no tax' finds its proper application. This conception of stability,

referred to as supplying an excellent series of illustrations. Enormous surpluses have been followed by considerable deficits, accompanied by grave economic disturbance.

moreover, comprises the fragment of truth wrapped up in Canard's erroneous doctrine of equal diffusion.[1]

'That taxation should be convenient' is another of the accredited maxims, which almost carries its justification on its face. It includes the selection of suitable objects for taxation, and also the choice of convenient periods for requiring payment. This rule of convenience is but the expression in a special form of the general principle that the public power should as far as possible adjust its proceedings to the habits of the community, and avoid any efforts at directing the conduct of the citizens in order to facilitate its own operations. The sacrifices that inconvenient methods of fiscal administration impose may indeed be treated as violations of both economy and equity.

§ 6. Such are the general canons that experience seems to prescribe, and which should be observed in a well-ordered State. They are, it is true, of a rather elementary character, but general and comprehensive maxims could hardly be anything else. Besides, their simplicity has not saved them from frequent violation. Their value lies in their assertion of truths 'plain and intelligible to common understandings,'[2] but for that very reason too often passed over. A system of taxation which conforms to them may without hesitation be pronounced a good one. Where they are neglected and broken through, the evil consequences will be almost certainly conspicuous.

A further point deserves notice. There is at first sight a probability of conflict between the several canons. A productive tax may be inconvenient, as a convenient one may be unjust; and how, it may be asked, is a solution of the difficulty to be reached? The plain answer is, By the surrender of the less important rule. The successful

[1] President Hadly in his valuable *Economics* lays stress on the advantages of 'certainty,' but he connects it with proper assessment, which is essential in order to avoid 'uncertainty of primary incidence,' *Economics*, 451–9. *Journal of Political Economy*, v. 86–9. This, however, seems as much a matter of 'equality' as of certainty.

[2] *Wealth of Nations*, 286.

administration of the State is the final object, and therefore convenience, or even equity, may have to yield to productiveness. But though opposition is possible, agreement is on the whole the ordinary case. We have seen that economy increases productiveness, but so do certainty and convenience. Elasticity aids both productiveness and economy, while growing productiveness in turn permits of better observance of all the other canons. There is thus a harmony in a properly administered financial system that tends to promote its improvement in the future.[1]

[1] Cp. with the maxims given in the text those enumerated by Mr. C. S. Devas, *Political Economy*, 606. It would be possible to frame many derivative rules—as *e.g.* 'Taxation should be diversified'—but they could not lay claim to general application, and most of them belong more fitly to the treatment of special taxes (Bk. iv.).

BOOK IV

PUBLIC REVENUE.—*Concluded*

THE SEVERAL KINDS OF TAXES

CHAPTER I

TAXES ON LAND

§ 1. In the preceding book we have dealt with the subject of taxation under its general aspects as the principal element of the financial system. We have now to complete our inquiry by examining the characteristics of the different kinds of taxes, and we may begin this discussion with one of the oldest and most widely employed forms of compulsory contribution—that levied on land. The interest and importance of this kind of taxation need not be insisted on. Perhaps some capitation taxes or a rude form of the property tax can claim a higher antiquity, but in ancient, mediæval, and modern times, in backward and in progressive societies, we meet with something in the shape of taxation on land as one of the primary agents of production. The economic nature of the impost and the particular methods adopted vary; the existence of some form of public charge on land is almost universal, and shows no sign of decrease. Greater financial knowledge and more efficient regulations produce considerable changes. Indeed, it is this development that chiefly needs our attention. From the first feeble attempts of early societies up to the elaborate processes of modern administration, we can trace progress through a series of stages which illustrate the historical movement.

§ 2. Regarding land itself as the 'object' to be taxed, the most obvious 'unit' in a new community would be that

of a given area. Assume that none but very fertile land is cultivated, and that only in a simple manner, and the tax by area will be also the just one. Each unit is of about the same value and employs about the same amount of capital and labour. The early taxes on *Jugera* in Rome and on 'hides' in England were probably at first based on this system, though they soon departed from it, and at present a few of the English dependencies retain it.[1] But as soon as differences in qualities of soil and in modes of cultivation become noticeable, the method ceases to be fair.

Another form of land tax, that in proportion to the produce, is of greater antiquity. Eastern sovereigns receive their revenue usually in this manner. One-fourth, as in India, one-fifth, as in Egypt, or more frequently one-tenth of the yield was claimed by the monarch. This 'tithe system,' as it may be called, arose out of the ruler's part-proprietorship of the soil. The proportional tax on produce was closely analogous to a *métayer* rent. It was partly adjusted to the fertility of the land, and did not press so heavily on the poor soils as the area tax. Under a competitive system its immediate burden would fall on the consumers of agricultural products through the rise of price, though the ultimate effect would be to check cultivation, and therefore to lower rent. As the system has been generally applied to societies in the customary stage the pressure came on the cultivator, who is at once the producer and the chief consumer of those commodities.

These primitive methods are improved, either by arranging land in classes according to its quality and applying a different rate to each class, or by varying the proportion of produce taken according to the method of cultivation. As soon as the elements of fertility and proximity to market begin to tell, it is evident that a uniform rate falls

[1] Dowell, i. 8, for the 'hide.' For the *Jugerum*, Mommsen, *Hist. Rom.* i. 95. St. Vincent and British Guiana have the uniform tax. Parl. Papers (1891), 181, *Taxation of Land.*

with undue severity on the poor and distant lands, either hindering their cultivation or raising the value of all produce. Consequently we meet efforts at differentiation in various countries. Under the Roman Empire land in some provinces was divided into that of first, second, third, or other fertility, and the rate was adjusted accordingly; in others one-fifth or one-seventh of the yield was taken.[1] In later times the Duchy of Mecklenburg had its land graded into three classes, with a different rate on each, and some of the Indian assessments have a like idea as their base.[2] These modifications show some consciousness that the real value of the agent, land, is not to be measured either by its surface area or its gross produce. They are, however, but imperfect attempts at reaching the true aim of a land tax, the value embodied in the object. A tithe or other proportional produce tax does not allow for the expenses of production; as equal amounts of produce are often due to very different quantities of outlay, such a tax discourages the employment of capital and is practically inconvenient in the form of assessment.[3] A classification of soils gives some, though insufficient, recognition to the influence of natural fertility. Far more is required. The effort to get at the true value of the 'object' is attained in respect to the land tax when it is levied on the net yield. The capital of the cultivator and the profits due to it have to be estimated in order to ascertain the income derived from the soil itself. Political equity and financial expediency have both contributed to this result; the fairest and most productive land tax is, on the whole, that which takes the net return as its standard. Fiscal practice tended in this direction. The financial reform of Diocletian seems

[1] Clamageran, i. 16.

[2] 'Land (in Ohio) was divided into three classes, according to quality, and there were three rates of taxation per 100 acres; one for land of the first quality, another for land of the second quality, and still another for land of the third quality,' Ely, *Taxation*, 134.

[3] Restraints must be placed on the sale of crops until they are inspected by the tax-collector and his share settled.

to have adopted a unit of value, not of area (*Jugum*), as the base for taxation of land. The English 'hide' came to be regarded as the 'carucate' of variable area but constant value.[1]

The mediæval land taxes are so much mixed up with rent and the incidents of tenure that little stress can be placed on their form; they are often parts of the older property tax, and only disentangled from it by degrees. Early English taxation 'reached the landowner through his cattle, farming stock and corn and other produce of lands,'[2] and the later subsidies had a rate on land as one of their component parts. In France the *Taille* was developed from the feudal dues and became permanent in 1445. But wherever the system of taxing land had to be applied, the idea of taking its value as the real object of taxation came to the front, though the difficulties in carrying it out caused the frequent adoption of the 'apportioned' tax, as in the case of the *Taille*, both the English 'tenths and fifteenths, and the subsidies, and, too, in the German and Italian land taxes.[3] The defects of these systems, with their exemptions and inequalities, made reform essential.

§ 3. It is far easier to point out the conditions of theoretic justice than to overcome the practical obstacles to arriving at the true net yield. The land tax system requires as its basis a valuation, and in the attempt to furnish this requisite various methods have been tried. Perhaps the simplest is that which follows the indications of the market, and uses as its guide the rent at which land is let. There is an obvious advantage in keeping close to the facts, but there is also great difficulty in ascertaining them correctly and following their successive changes. Adam Smith approved of the use of registers of leases, which he would make compulsory, and by their aid assess the land

[1] Wagner, iii. 26; Clamageran, i. 19. Seebohm, *English Village Community*, 290 sq. For England, Seebohm, 40; Dowell, iii. 67.

[2] Dowell, i. 5

[3] Vignes, i. 11; Dowell, i. 88, 154.

of occupying owners.[1] The selling value is another possible criterion; it is evidently related to rent as principal is to interest, and for short periods the proportion is steady. A tax directly based on the selling value of land is, however, a tax on property rather than on income.

The difficulties in ascertaining the actual rents, and in some countries the large proportion of occupying owners, have popularised the system of determining the value of land for taxation by official assessment based on survey and valuation. This method is evidently the older one. Thus the Roman provincial land tax had a survey as its foundation followed by valuation.[2] Domesday Book is a less perfect example of the same kind in England, and in one form or another valuations were common enough in the Middle Ages, but were in general used only for the ruder forms of land taxation, and dealt with the gross produce from the soil or its supposed capital value.

Refinements in fiscal methods require a corresponding elaboration in the valuation, or, to use the serviceable French term, *cadastre*,[3] on which they depend. Most of the controversies about the land tax turn on the method of cadastration, and the expediency of its revision at stated periods. For the completion of a *cadastre* a series of processes is needed; there must be the measurement of the surface, and its delineation by maps; the boundaries of properties must be marked, and the ownership specified. To this technical work the economic task of valuation succeeds. Estimates of produce and prices and of the cost of cultivation form the *data* on which the 'net annual value' is calculated. Each of these steps involves much labour, and is liable to error, more particularly in the economic part of the work. Produce must depend on the method and skill employed in cultivation, prices on many different conditions, and both, especially the latter, are fluctuating. Besides, to be really useful, a fiscal survey must deal with

[1] *Wealth of Nations*, 349-50.
[2] Wagner, iii. 25-6.
[3] Said to be derived from '*capistratum*.'

minute portions of the soil; each distinct piece (or *parcelle*) should be valued and revalued at intervals. Such an inquiry takes a long period to accomplish for any country, and by the time it is completed the results for the districts first treated have become antiquated.[1] However perfect when first started, a valuation must soon fail to represent the actual position of the land it deals with. The opening of new lines of communication, the adoption of a different style of farming, and the growth of towns will completely alter the old results.[2] The imperfections of the *cadastre* are grave enough from a theoretical point of view, but they also entail much hardship and injustice. Some persons and districts are unduly favoured, leaving to others to make up the amount that they have escaped paying. For example, in France (where the land tax is apportioned), some proprietors are taxed four times as heavily as others. The differences in Italian taxation were still greater, owing to the use of different cadastral bases for different districts.[3] Between the difficulties that adherence to an old valuation causes, and those due to the expense and confusion of incessant renewals of the *cadastre*, it appears that the safer course is to keep the original valuations checked by the actual letting values of land. Apart from the expense of continual revaluation, it is also true that the 'net annual value' or the 'net income' of official estimations is in a sense hypocritical, as it depends on the accuracy of

[1] 'The survey and valuation of Bohemia is said to have been the work of more than a hundred years.' *Wealth of Nations*, 351. The French *cadastre*, begun in 1807, was not completed till 1850. In Madras we hear that 'in 1855 the work of survey and re-settlement was begun. This work will be accomplished in or about 1895, but certain districts of the Presidency will then have seen this very re-settlement expire.' Goodrich, *Economic Journal*, i. 451. In like manner the Irish valuation usually known as 'Griffiths's' has become by lapse of time very misleading.

[2] Three valuations of Lancashire made in 1790, 1840, and 1890 respectively, would have few common, or even proportional results.

[3] Leroy-Beaulieu, i. 343. For Italy, Alessio, i. 224–5; Fournier de Flaix, *Traité*, 498. According to the former, land was taxed in Lombardy, at 25 per cent., in Liguria at 7 per cent.; the latter gives 79 per cent. for Modena and 17 per cent. for Sicily. A new *cadastre* for Italy is proposed.

the assumptions made for the purpose. There is, however, the qualifying fact that a well-executed *cadastre* is of use for other purposes. A careful survey is essential for facilitating the transfer of land, so that it is merely the economic part that could in any case be dispensed with. There seems to be no great obstacle to a gradual revision of the general valuation, supplemented by local valuations strictly on the letting value. In this way the former would be a slowly changing norm, while the latter would recognise the actual movements of land value.

§ 4. But whatever may be the hindrances in the way of securing a perfect adjustment of the land tax, there is no doubt that most financial systems use it as a substantial resource. The so-called English land-tax has really been converted into a rent charge;[1] but Schedule A of the income tax comprises land and houses, the former in 1899—1900 being £52,814,000 in value, yielding at the rate of 8*d.* less than £1,800,000. To this sum has to be added the portion of local rates falling on land. Using the proportion of land to houses under Schedule A as a guide to the division of rates between the two classes, we would get about 23 per cent. for the share of land. As the rates for 1898–9 were over £38,600,000 this method would give £9,070,000 as the local charge on land for England and Wales.[2] As, however, the poor rate valuation differs materially from that employed for income tax, it becomes necessary to consider the estimated distribution of local burdens. According to Sir H. Fowler, land in 1891 bore a little over 15 per cent., while houses contributed nearly

[1] Bk. ii. ch. 4, § 5.

[2] Schedule A—

	Land.	*Houses.*	*Land.*	*Houses.*
1899-1900	52,814,000	174,431,000	23½ per cent.	76½ per cent.

Local Rates for 1898-99—

England and Wales	£38,602,000
Scotland	3,824,000
Ireland	3,234,000

In the last country the returns from gas and waterworks are included in the rates, but are unimportant.

85 per cent.; or, to put the matter in a simpler form, land paid only one-sixth, against five-sixths derived from houses. Thus the true contribution from land in England and Wales would be somewhat over £6,400,000.[1] Scotland and Ireland show a larger proportion; 50 per cent. would in their case be the share of land, and, we may say that, of the total £7,000,000, £3,500,000 would fall on land. The extent to which the taxation of houses falls on ground rent is—at least for statistical purposes—an insoluble problem; but, omitting it for the present, we get a total taxation of nearly £10,000,000 on land for the United Kingdom. How far this represents a charge on pure land value, as distinct from that on investments of capital, is questionable. We need not in any case hesitate to ascribe the greater part to the value of the land, not to the improvements. When we add to the above the tithes and tithe rent charges, so far as they are devoted to ecclesiastical or other public purposes the total reaches £12,500,000. Allowing for considerable under-valuation in the figures of Schedule A,[2] it is nevertheless beyond doubt that land contributes largely to the public requirements.

At the same time we must remember that a great deal of this burden is of long standing; the income tax has been for sixty years in continuous operation, and, in the early part of the century, the poor rate was excessive. There is no evidence of new and oppressive charges being imposed. The growth of local taxation, as Lord Goschen has shown,[3] has chiefly affected the towns, while, until recently, the rent of land was rising.

§ 5. On passing to France we meet with a very different system of land taxation. The old *Taille*, whose defects were universally recognised, was supplemented in 1710 by the *Dixième*, and from 1748 a *Vingtième* was levied. These

[1] *Local Taxation Report* (No. 168, 1893) xxxvii–xl. Cp. Blunden, *Local Taxation and Finance*, 62.

[2] Owing to the great fall in the value of land the assessments are now probably up to, or in some cases beyond, the true amount.

[3] *Local Taxation*, 17, 50. Cp. Mr. Fowler's *Local Taxation Report*, xxxv.

'tenths' and 'twentieths' were rather income, than pure land taxes, but were abolished at the Revolution along with the *Taille*, and the modern system was inaugurated.

The decree of December, 1790, established the *Impôt foncier*, which was to be apportioned on all landed property in proportion to its 'net revenue.' This phrase is evidently due to physiocratic influence, and was explained to mean what remained over after all expenses were deducted from the gross produce. The tax was to be a fixed sum apportioned among the contributories, and to be payable in money. It was not to exceed one-sixth of the net revenue, and, on the loose estimate that 240,000,000 francs would be one-sixth, the contribution was fixed at that amount, with an additional 60,000,000 francs for local taxation. The disturbances of the Revolutionary period hindered the collection of this impost, and the unequal pressure, owing to the absence of proper valuations, was the ground of successive reductions, by which the total amount, from being 240,000,000 francs in 1790-6, fell to 150,000,000 in 1821. In 1835, the increased value of house property, which is included by the law of 1790, was taken into account. The additional *centimes*—really an increase of the tax—were given up in 1850, and by 1880 the total amount was almost 174,000,000 francs (£7,000,000). The extra *centimes* for the departments and communes were very nearly trebled in amount since 1820; in 1880 they were 94,000,000 francs and 82,000,000 francs respectively.[1] The loud complaints of agriculturists as to the inequali-

[1] More precise figures are—

	1820	1840	1860	1880	1900*
	Francs.	*Francs.*	*Francs.*	*Francs.*	*Francs.*
Principal amount . . .	168,225,220	155,669,805	163,837,194	173,827,511	103,168,643
Additional centimes for general purposes . . .	42,899,677	33,936,017	—	—	8,377,293
Ditto for departments .	36,568,634	47,629,611	70,238,036	94,077,070	69,158,840
Ditto for communes . .	28,518,003	24,820,985	45,683,257	81,904,095	63,647,717
Ditto for relief, &c. .	3,768,747	3,601,486	4,476,168	5,350,874	9,110,182
Total	279,980,281	265,657,904	284,234,655	355,159,550	253,462,675

* The figures for 1900 include only the land tax proper (*Propriétés non bâties*).

ties and unjust pressure of the *Impôt foncier* led to a reform in 1890, by which the house tax was separated from the land tax, and the latter, which had been 118,000,000 francs, was reduced to 103,000,000 francs. By a law of 1897 the smaller properties were relieved. The result has been that, in 1900, even with an extra charge of 8 per cent. on the original general tax, the total taxation on land stands at 253,000,000 francs or £10,120,000. The increase of house property and buildings has supplied a new object for the heavier taxation, as in the case of England. The land tax remains one of apportionment, while the house tax, or more strictly that on land with buildings (*Propriété bâtie*), has become rated, and is fixed for the present at 3·20 per cent. The next step in reform will probably be the abandonment of the apportioning of the land tax in favour of the more suitable rated system.[1]

§ 6. The Italian land tax is a development from the taxes of the several Italian States. As the simplest course, 110,000,000 lire was the amount fixed for apportionment among the different divisions. Measures of reform have been since attempted. The tax on buildings was separated in 1865 and made a rated tax, and redistributions of the total charge among the provinces were carried out. The defective scheme of the old *cadastres* has led to the enactment of a law prescribing the preparation of a new and uniform one for all Italy. The variations in amount of the land tax have been from 125,000,000 lire to about 96,000,000 lire, *i.e.* speaking generally, from about £4,000,000 to £5,000,000, but the local taxation has to be added. Thus for the year 1886–7 the provincial tax was 53,000,000 lire and the communal one 76,000,000 lire, which, with 110,000,000 lire, the general land tax for that year, made a total of 240,000,000 lire (£9,600,000)—a much higher charge than that of France. In qualification it must, however, be noticed that the whole taxation of Italy is far heavier. The most serious grievance is found in the

[1] For the French land tax, Stourm, i. 124–220: Vignes, i. 25–39. *Dict des Finances*, s. v. '*Foncière*.'

instances of heavily taxed communes, where the greater part of the value of land is absorbed in taxation. So far has this been carried that there have been many cases of evictions by the State.[1] Inequality in distribution and excessive weight in amount are the gravest possible defects in any tax. The new valuation, though costly, will remedy the former, but the latter is a question of policy as well as finance.

The Spanish land tax, which received its present form in 1845, includes stock, and is therefore more primitive. Owing to the want of a correct valuation, the charges are very imperfectly distributed. The proportion fixed for 1890–1 was 15½ per cent. on those places that have given a satisfactory declaration of value, for others 17½ per cent. The yield for 1900 exceeded 160,000,000 pesetas (£6,680,000), with over 17,000,000 pesetas (£680,000) for local purposes. The law of March, 1900, makes provision for a proper valuation of houses, land, and cattle, which will increase the efficiency of the land tax.

The Portuguese land tax is closely on the lines of the French *Impôt foncier*. It was originally rated, but since 1852 has been apportioned; it, is however, proposed to return to the rated method. The yield is nearly 3,000,000 milreis (about £650,000), after paying assessment expenses.

Belgium has a rated tax based on an elaborate valuation. Up to 1867 the method of apportionment was employed. The annual amount for national purposes for 1900 was over £1,000,000, with additional *centimes* for local government of nearly £700,000.[2]

Greece, which possessed the tithe system till 1880, has

[1] En 1876, 6,614 propriétés étaient expropriées par le Fisc pour le recouvrement de 936,774 francs d'impôt, et en 1877, 6,644 propriétés pour 662,722 francs. Le Fisc dévore la petite propriété trop obérée. De 1873 à 1878, 35,074 petits propriétaires ont perdu leur avoir par l'expropriation forcée. Laveleye, *Lettres d'Italie* (1880), 161–2. For the Italian land tax, De Parieu, i. 205–218; Alessio, *Sistema Tributario*, i. 88–232.

[2] More accurate figures for 1900 are—

For the State, 25,924,130 francs.
For Provinces, 3,895,846 francs.
For Communes, 13,307,506 francs.

now a rather primitive but yet complicated group of 'land taxes' on labouring animals, on area, and certain products, yielding altogether about £500,000.

§ 7. The land taxes are confined to the several States of the German Empire, the imperial revenue being derived mainly from indirect taxation. With numerous differences in detail, there is the general system of basing the tax on official valuation. The Prussian land tax, inherited from the 18th century, was reformed in the period 1810–20; a new valuation was arranged, and inequalities in the distribution between the different provinces modified; but the survivals of the older system of privilege prevented complete success in this object. In 1821 its yield was under £1,500,000. These inequalities were dealt with by the legislation of 1861. The house tax was separated, and for the land tax the amount was fixed at 10,000,000 thalers (£1,500,000) from 1865, and a fresh valuation carried out. The new Prussian provinces, acquired in 1866, added 3,200,000 thalers (£480,000) to this fixed sum, giving a total of £2,000,000. The amount of the additional local charges was somewhat uncertain, but for the year 1880–1 the communal and provincial extra land taxes were equal to those of the State in amount (£2,000,000), giving a total burden on land of £4,000,000, independent of the action of the income tax.

Under the legislation of 1893 the state land tax, in common with the house and business taxes, has been surrendered by the Prussian government in order to provide the local subdivisions with adequate objects of taxation. This long-proposed transfer only came into effect for the financial year commencing April 1, 1895.

Each of the smaller German States employs some form of land tax. Bavaria shows a less developed form in its reference to gross produce as the basis of calculation. The cadastral surveys are in most cases elaborate, and serve other than fiscal purposes, such as facilitating the transfer of land The *communes* of the several States also

receive contributions through additions to the land tax.[1]

Austria has developed a land tax on a similar type. By the reform of 1817 the valuation of the 18th century was to be replaced by a new one completed in 1856. The house tax was separated in 1820. In 1879 a law for revision was passed, and in 1881 the annual amount was fixed at 35,190,000 florins for fifteen years, a new valuation to be then made. The Hungarian land tax was almost the same sum (35,000,000 florins), and the local charges in Austria levied on land were believed to reach the like amount. Thus the burden on land in Austria proper is under £7,000,000.

Taxation of land in the United States is imposed through the general property tax, which, as we shall see, presses with undue weight on real property, but its discussion belongs to a later chapter.[2] Nor need the Indian land revenue be again considered.

§ 8. The foregoing notices of the land taxation of some of the principal countries bring out its characteristic features. Specially worthy of observation are: first, the considerable amount contributed on the whole, and to both general and local revenues. The absolute amount appears to be highest in England, but everywhere a good percentage of the net annual returns is taken for public use.[3] Another very common circumstance is the employment of the system of apportionment. A total fixed sum is thus secured, and as each district must pay its part, it has a manifest interest in making all contribute fairly; nevertheless, the method has the great defect of rendering an important part of the tax revenue inelastic, and it is likely to reduce the land tax to a rent charge, as has happened in the case of England. The rated or percentage system is free from these faults, and is therefore the best suited for modern

[1] For the German land taxes, Cohn, §§ 303–6; Wagner, vol. iv.; Fournier de Flaix, 393 sq.

[2] Bk. iv. ch. 4, § 3.

[3] Probably lowest in Saxony.

finance. A third question intimately connected with the land tax is that of valuation. If the 'rated' system be used, it is necessary in the interests of justice that the basis on which the estimate of value is made should be uniform. Thus *e.g.* the English valuation of land is believed to be closer to the true value than the Irish one, from which it follows that the income tax in its A schedule is not the same in the two countries.[1] The Italian land tax affords a more extreme instance of the same evil. In all countries this inequality must in some degree exist between individuals and smaller districts, but this fact only strengthens the claim for all practicable efforts to secure the removal of proven injustices. Even if it be impossible to alter quickly the particular forms of the tax, there is an advantage in knowing the amount of inequality, which can then be compensated by the adjustment of other taxes.

Finally, the land tax is what has been called a 'real' tax; it deals with the object, land, and takes no note of the position of the proprietor. When properly developed it is proportioned to net produce, and therefore allows for the expenses of working the soil. For the same reason it should not take indebtedness into account.[2] Charges on land are a part of the net return, and have no claim to deduction. A variable land tax may therefore press with great severity on encumbered proprietors who have to pay the tax on the interest of their debts. Any attempt to remedy this evil has the necessary result of creating a partial tax on interest of capital, and, if unaccompanied by taxation of other forms of capital, would either discourage loans to owners of land or raise the interest on mortgages. The conclusion suggested by these facts is that the land tax had best be absorbed in a general income tax,

[1] It does not follow, as has been asserted, that Ireland suffers from this system. It would on the whole tell in her favour.

[2] Professor Seligman—*Political Science Quarterly*, vii. 719—seems to question this proposition, which nevertheless is a necessary deduction from the nature of the land tax.

when part of the burden would, as under existing English arrangements, be paid by the creditors. If, on the other hand, the distinct land tax be retained, two courses are open: either to retain it at a fixed amount, when it becomes a rent charge, an undesirable proceeding, or to give it up to local bodies. We have seen that taxes on real property are a good form of local revenue,[1] and both in France and the United States this treatment, which is in accordance with British practice, has been proposed. The actual condition in Germany with its numerous smaller States partly attains this result, which has been reached in Prussia by the reforms of 1893.[2]

§ 9. The incidence of the land tax is a final question for consideration. In its ruder forms the pressure fell chiefly on the actual cultivators, though the ultimate effect of heavy taxation must have been felt by the proprietors in the check to agricultural improvement and the diminution in their dues. On the hypothesis of competition, a proportional tax on produce, *e.g.* a tithe, would tend to raise prices, and thus at first fall on the consumer, unless there was free importation of the article from abroad. Such was Ricardo's reasoning in respect to tithes, which had to be paid from land at the margin of cultivation, and which consequently yielded no rent. He failed to see the inevitable effect of dearer food in retarding the progress of the community, and thereby preventing the increase of rent. The pressure of a tithe is surely, as time elapses, in greater degree passed on to the landlords.[3] As soon as net return is taken as the standard for taxation, rent is the element affected. A land tax, therefore, in its developed

[1] Bk. iii. ch. 6, § 4. The recent Prussian legislation noticed in § 7 is in accordance with the doctrine here laid down.

[2] The proposal was made by Léon Say in the debates on the *Impôt foncier* in 1890 (*Finances de la France*, iii. 437), and by Professor Ely, *Taxation*, 251–3, who would exempt land from even 'State' taxation.

[3] See Ricardo, *Principles*, ch. 9. McCulloch, Senior, and J. S. Mill all desert him in this case. See Bk. iii. ch. 5, § 6; also J. S. Mill, *Principles*, Bk. v. ch. 4, § 4.

form, may not inaccurately be regarded as a tax on rent, and the general principles of incidence applied to it. In actual working, however, various complications arise. The action of competition is not always found in full force, and so far as any portion of the pure economic rent is held by the immediate payer—tenant or other—he has to submit to the burden.[1] A land tax may also affect the interests of labour. If investment of capital in agriculture is checked, and if the rate of wages is easily affected by the action of employers (as has been often the case), taxation on the cultivator may be shifted, not to the landlord by lowering rent, but to the labourer by lowering wages, or in a time of rising prices by preventing their proportional increase in money.[2] Again, the fact that the land which is the object of taxation often owes its value to the capital sunk in it makes the burden fall on the yield of fixed capital, a point which has been already considered.[3]

A more difficult and disputable point arises in connexion with the incidence of a long-continued land tax. Here it is said that the tax is really a deduction from property. As land is sought for its revenue, whatever lowers its revenue lowers its selling price, and therefore a land tax falls altogether on the possessor at the time of its imposition. Subsequent acquirers take the land subject to the burden, and pay a lower price in consequence. This process of 'amortisation,' as it has been called, makes the subsequent removal of the tax undesirable; the persons who have lost

[1] 'As a matter of fact it appears that a great portion of the farms in England are not rack-rented. If so, it is clear that any increase in local burdens must fall on the margin between the actual rent and the rack-rent, and so far diminish the advantage derived by the farmer from his actual rent being below a rack-rent, and till that margin were exhausted it would naturally be useless for him to apply to his landlord to readjust his rent.' Goschen, *Local Taxation*, 165. But as Mr. Blunden (*Local Taxation and Finance*, 42) points out, in times of depression this may tell in a different way. Rents continue above the economic level, and the rates paid by the occupier are an aggravation of his position.

[2] See Leslie, *Essays*, 395–7, for an illustration.

[3] See Bk. iii. ch. 5, § 6.

by its establishment are not the same as those who gain by its remission. A purchaser buys land at a lower price in consequence of the tax, and gains a like advantage by its removal; in fact, he is allowed for it twice over, once at the time of purchase and again at that of remission.

The elements of truth in this theory, which has received much favour, appear to be the following: (1) as previously pointed out,[1] when a land tax becomes definitely fixed, so that it can be foreseen, or even capitalised and redeemed, there is no inaccuracy in speaking of it as a charge on land which lowers its selling price; it is just the same as a mortgage, and is so regarded by purchasers; (2) a stable tax of any kind has some of the advantages to which Canard gives such exaggerated importance. Its pressure is more regular, and therefore less felt. An invariable land tax undoubtedly has this in its favour. On the other hand, there is no reason for regarding the modern land taxes as perfectly stable and fixed. In transactions with respect to land there are not merely the existing but the prospective burdens to be taken into account. To assume, *e.g.* that the French '*centimes additionnels*' or the English local rates have been 'amortised' would be an obvious error. We cannot foresee the future movement of taxation in respect to land, and we cannot expect that the present systems will always continue. Another important consideration is the relation of land taxation to the other forms. If it should happen to be unduly heavy there would be a tendency to depress the value of the land so taxed, just as if it were too light its effect would be the opposite; but this is characteristic of all taxation. Tea, sugar, or any other commodity will have its value for the time being affected by the creation or remission of a special tax on it. But where there is a due proportion of taxation to the several forms of income, the investor in land will only receive the same proportional return as he would obtain in other directions. Any alteration in the land tax ought to

[1] Bk. ii. ch. 4, § 5.

have as its motive the effort to secure a more equal distribution of burdens, and to this there can be no valid objection. At the same time, where a tax has been recognised as at once special and definitely fixed, it seems to pass out of the ordinary category of taxes and into that of charges, a transformation only possible in the case of durable productive wealth, and most prominent in respect to land.

CHAPTER II

TAXES ON CAPITAL AND BUSINESS

§ 1. For fiscal purposes durable capital has the closest resemblance to land—the two are indeed sometimes inextricably mixed up together—and of its different forms houses and buildings generally are the most important from the same point of view. Sometimes as an integral part of the land tax, but more often with a distinct position, we find the charge on houses used both for local and general purposes. The reasons for its employment are to be found, partly in its connexion with land, partly in the universality of the use of houses, which extends taxation to all classes, partly in the convenience and readiness of assessment, and finally in the belief that the value of a person's house was a satisfactory test of his income. These considerations have very different weight at different periods. In early times the one object was to secure receipts, and for this purpose houses, or something connected with them, were convenient objects of imposition.

As in the case of land, the precise form adopted varied; at first houses were taxed simply as part of the land on which they stood, being treated as a particular kind of improvement. The hearth or chimney tax was in use in the feudal period. The substitution of windows for chimneys made another variety, to be succeeded by taxation assessed according to the class of house, or the letting value. The problems and course of development

of the land tax reappear with modifications in the case of the house tax.

§ 2. England shows this development. The hearth tax, established in 1662, was so unpopular that it was abolished in 1688, but soon replaced by the window tax, under which a scale of payment was fixed—ten windows and under, 1*s.*, increasing at a higher rate for a larger number. With several changes in the rates, and with additional stringent provisions to check evasion, the tax continued all through the eighteenth century. In 1815 its yield was about £2,000,000. Sounder ideas of taxation led to its repeal in 1851. Adam Smith's suggestion that inhabited houses should be taxed on their annual value was adopted in 1778, in addition to the existing window tax. Houses under £5 value were to be free; those between £5 and £50 to pay 6*d.* in the pound (2½ per cent.); those over £50, 1*s.* (5 per cent.). Several increases of the tax were made for war purposes, till in 1808 the rate on houses of £40 and over was 2*s.* 10*d.*, or nearly 15 per cent. By a curious selection the house duty was repealed in 1834 instead of the window tax, but on the repeal of the latter in 1851 it was reimposed. Houses under £20 were exempted, and business premises paid only two-thirds of the rate on ordinary houses, *i.e.*, 6*d.* and 9*d.* per pound respectively. The last change has been made in 1890, when Lord Goschen restored the old system of grading. Houses between £20 and £40 pay only 3*d.*, and those between £40 and £60, 6*d.*, the corresponding rate on business premises being 2*d.* and 4*d.* The yield of the tax was by those changes somewhat reduced from its highest point of £2,000,000; in 1900–1 it amounted to £1,700,000.[1]

To arrive at the total pressure of taxation on buildings we must add (1) the income tax in schedule A, amounting at 8*d.* to about £4,850,000, and (2) the great mass of local rates. Taking the figures in the last chapter, if the balance of rates can be assigned to buildings, we would get the

[1] On the English house and window taxes, *Wealth of Nations*, 355–357; Dowell, iii. 165–192.

enormous sum of £35,700,000, as their local taxation.[1] The occupier, the ground landlord, and, in the case of business establishments, the consumers of the commodities are all participants in the burden, but we must again note that a great deal of this expenditure is economically reproductive, so that the taxes are paid out of a fund created by their employment.

§ 3. France has not reached the same stage of development as England in regard to this form of taxation. The separation of the land and house taxes has only lately been accomplished, and the door and window tax still exists. in addition to the *Mobilier*, or tax on letting value. The latter, suggested under the monarchy as a substitute for the personal *Taille*, was in its origin, as established by the Constituent Assembly in 1791, a tax on income, based on the presumption that house rent was a measure of its amount, but owing to the belief that income increased more rapidly than the cost of housing, the tax was on a progressive scale so calculated as to be proportional to income, and some qualifications were made by using other elements. In 1798 these refinements were abolished, and the *Mobilier* became a house tax. The tax (which is combined with the personal tax, to be discussed in the next chapter) is apportioned, and amounts to about £3,500,000, of which nine-tenths come from the house tax part.[2] The contributions to local taxation

[1] Bk. iv. ch. 1, § 4. Sir H. Fowler's estimate for England and Wales in 1891 was £23,560,000, but it should be remembered that other property is included under this heading. *Local Taxation Report*, xl.

[2] The yield of the *Personnelle mobilière* has been as follows—

FRANCS (000's omitted).

	Principal.	*Additional Centimes.*
1830.....	27,161	14,100
1870.....	46,004	44,337
1880.....	52,161	64,382
1885.....	57,846	74,240
1890.....	64,066	84,400
1900.....	72,700	102,675

through the additional *centimes*[1] are of an even larger amount.

The door and window tax was established under the Directory in 1798. At first a rated tax, it was apportioned in 1802, and, with the exception of 1831-2, it has so continued, with a steady increase in amount. From a little over £500,000 in 1830 it has risen to nearly £1,600,000 in 1885, and £1,900,000 in 1900, while the additional *centimes*, that were only £100,000 in 1830, exceeded £2,000,000 in 1900. The total may therefore be regarded as about £4,000,000, obtained by an inconvenient and vexatious method.[2] To the foregoing the building tax, now separated from the pure land tax, adds a sum of £3,000,000 for the principal, with additions coming very close to £3,600,000 (£3,150,000 of that amount being for the *communes* and departments in about equal proportion). As the tax is now a rated one the increase in value of house property, even if the present rate is maintained, will add to the yield. The total burden on houses is therefore, speaking broadly, about £17,000,000.[3]

[1] Some of which, however, are reserved for the central government. In 1890 the *centimes additionnels* raised for state purposes came to 18,262,000 francs.

[2] The figures for the 'door and window' tax are—

FRANCS (000's omitted).

	Principal.	*Additional.*
1830	12,812	2,711
1870	33,911	23,750
1880	36,588	33,594
1885	39,703	38,320
1890	42,609	42,186
1900	47,455	51,350

[3] The *Impôt foncier* on *propriétés bâties*, now separated from the land tax proper, gives the following results—

FRANCS (000's omitted).

	Principal.	*Additional.*	*Additional for departments.*	*Additional for communes.*	*Total.*
1890	63,418	8,739	32,422	33,936	138,575
1895	68,722	10,647	35,588	37,147	152,104
1900	72,911	12,579	38,362	39,623	163,475

Taking this with the preceding notes we reach the result in the text. Mr.

Italy had, as we saw, established a distinct house tax in 1865. The amount obtained by it in 1866 was £1,300,000; by 1886 it had more than doubled, being nearly £2,650,000. Moreover the local charges, superimposed on the principal, came to almost the same amount. For the year 1892–3 the total State taxation amounted to £3,435,000. Though the absolute amount is much less, the pressure is probably greater than in England or France.[1]

Belgium, Spain, and Portugal do not separate their land and house taxes; it is therefore impossible to deal with them under this head.

The Prussian house tax was made distinct in 1861, and separately collected since 1865, being proportioned to value —2 per cent. (or 4 per cent. in the case of houses let to tenants). It grew with the increase of wealth from £850,000 in 1878 to over £1,500,000 in 1889–90. The local charges came to less than half that amount, giving a total of about £2,200,000.[2] Like the land tax it passed from the State to the local bodies in the financial year 1895–6.

In most of the smaller German States the house tax is a part of the land tax. Bavaria, as in the case of land, applies the 'area' and 'productive power' principle to the taxation of houses.

The Austrian house tax, in existence since 1820, yielded for 1893–4 about £3,000,000, and that for Hungary, about £1,000,000, not including the local charges.[3]

§ 4. From the facts just given, we can see that the course of development in respect to the taxation of buildings is towards taking their value, or, if possible, their annual yield, as the basis of assessment, and at the same

Egerton in the year 1890, estimated that 'the total tax on land and houses in France will be found to amount this year to about £15,000,000 independently of the personal and '*mobilière*' tax of £5,500,000 and of the door and window tax of over £3,000,000.' *Reports as to the Taxation of Land and Buildings*, (C. 6209), 16.

[1] For the Italian house tax, Alessio, i. 233–266.

[2] Cohn, § 306; *Reports on Taxation* (C. 6209), 31.

[3] *I.e.* taking the florin at 2*s*. The figures are—Austria, 30,713,000 florins; Hungary, 10,000,000 florins.

time towards separating them from land. The French door and window tax may, therefore, be at once condemned as a pernicious survival of an antiquated method: its abolition, or absorption in the *mobilier*, is merely a question of time.

The problem of assessment has usually been dealt with in the way approved by Adam Smith, but with a large allowance for expenses and repairs, varying in the different countries. On the whole, it is easier to ascertain the letting value of houses than of land, and there is, besides, the element of cost of construction to be used as a corrective. Some difficulties, however, certainly exist. It is not easy to deal with deterioration and the resulting loss of value, more particularly in respect to buildings employed in production. Revaluation at short intervals is the only suitable way, but it is both troublesome and expensive. The opposite case, *i.e.* where improvements have been made, is also complicated. Increased value ought certainly to be taxed, but the effect in checking improvements is serious. The usual course of allowing a period to elapse before rating new constructions affords the best practical solution.

The taxation of expensive private dwellings, such as noblemen's mansions, has attracted more attention than its intrinsic importance warrants. In England such houses have been rated at a nominal figure on account of the supposed expense of maintaining them, which is thought to reduce their letting value. On the other hand, the cost of construction, or again that of reconstruction, has been proposed as the basis for valuation. Neither is, however, adequate. Letting value fails where the objects are not really and in fact let to tenants. Cost would give much too high a value in some cases, as expenditure is not always represented by additional value. The true test in such cases lies in the utility of the house and surroundings, which selling or market letting value would measure, but which, in its absence, must be estimated, either by reference

to similar dwellings let elsewhere,[1] or by the probable expenditure of the possessor on his house accommodation. The modern tendency to apply commercial principles, even to aristocratic residences and estates, will afford a means of readily gauging value in these instances.

§ 5. Far more important is the very difficult question of the incidence of house and building taxes.[2] So many elements are combined that the assignment to each of its separate share is a task of some complication. The value of the ground on which the buildings stand is determined by the law of rent, and a tax that falls on it would, therefore, appear to be untransferable. A house is a particular kind of commodity, and its share of taxation may be supposed to come under the laws that determine the incidence of taxes on commodities. Accordingly, Adam Smith, Ricardo, and Mill have agreed in asserting that taxes on ground rent fall on the landlord, while those on building rent fall on the occupier. The builder must, they thought, get his fair profit and will therefore escape taxation. The solution is unluckily not quite so simple. First, as to ground rent, wherever there is an alternative use for land, it is plain

[1] The plan adopted in the recent valuation of buildings in France, *Finanz Archiv*, viii. 193-4.

[2] Cp. with the discussion in the text the fuller treatment by Professor Seligman, *Incidence*, Part ii. ch. 3. His careful discrimination of the different effects of the tax according to its point of first imposition—on the landowner, builder, or occupier—is most valuable as a lesson in the effect of economic friction, but he seems to give too little weight to the forces that shift taxation on the ground owner. In his second edition, Professor Seligman remarks that this criticism 'seems to overlook' the statement in his text that 'as between the landowner and the tenant, the tenant is the weaker party' (*Incidence*, 241). The assertion so broadly made is a disputable one. It does not follow that because rent rises with increasing demand, it will rise still further in consequence of a tax. The difference of view as to the elasticity of demand for houses accounts for the difference on this point. Moreover, in the theory of incidence it happens that the holder of a differential gain is the weaker party (*infra*, Bk. vi. ch. 5, § 6). To avoid misapprehension, it must be added that it is not 'the tax' but a portion of it (as suggested by the word 'taxation') that has a tendency to pass on to the ground owner. Professor Edgeworth's complete agreement powerfully supports the position here taken (*Economic Journal*, vii. 66). See for further reference to the latest discussions Bk. iii. ch. 6, § 5.

that a tax on it, if employed for building, is strictly limited by that other use; thus until the rent of land for building exceeds that of agricultural land by the amount of the tax, no landlord will let it for that purpose. The tax on this minimum ground rent would be passed on to the builder, and by him to the occupier; but once it is reached the ground landlord has a differential gain, and cannot escape by withdrawing his land, as he would thereby lose still more. We can, therefore, accept the doctrine of the non-shifting of a tax on ground rent as generally true. The other part of the doctrine requires more consideration. The rent of houses depends proximately on the conditions of supply and demand; taxation levied from the occupier is equivalent to so much additional rent; it resembles a rise of price in the case of an ordinary commodity. The consequent check to demand tends to take off part of this increase, and therefore the initial effect is to throw some of the tax on the house owner.[1] As houses are a very durable commodity, the adjustment of supply to the altered demand may take a long time to accomplish. It will largely depend on the economic position of the locality; if it is progressing, the tax will hinder building until rent rises to its old level; but if it happens to be stationary or declining the burden remains on the house owners, who are the possessors of a particular kind of fixed capital. Even in an advancing locality the shifting may be on the ground rent. The increase of house rent that checks building thereby reduces the demand for building ground, and consequently lowers its value. It is highly probable that some at least of the burden will be so distributed. Or, again, it may happen that, owing to their situation, the premises command a specially high, or what is popularly called a monopoly value, in which case the owner, having obtained the highest possible rent, must submit to pay the public charges; the

[1] If the house tax were levied directly from the building owner, the influence of economic friction would keep part of the burden on him.

mere building owner will recoup himself at the ground landlord's expense.[1]

In the case of buildings used for production or business there may be a further shifting. The taxes levied on factories and shops form a part of the expenses of the manufacturer or trader, and tend to raise the prices of the commodities supplied by him; but where the taxation is uniformly distributed, a general rise of prices from this cause being impossible, the tax would not be transferred. As this uniformity is never really found, there will be a disturbance of values through taxation, with an ultimate incidence on interest and employers' gains. The taxation of houses in all countries varies according to locality, and the modern improvements in transport and business organisation have brought retail prices nearer to a general level. The result is that the shifting of building and house taxes to consumers of commodities is hardly possible, prices being limited by outside competition, and it must therefore be on the owners of the ground, in so far as it does not rest on the house owners, traders, and manufacturers in question. Still the levelling force of competition is not universal, and shifting is not always possible, and it may

[1] Professor Seligman (*Incidence*, 242 n.) asks, 'But why should the landowner take less? The building owner is in the weaker position, for his building is on the land and under the law goes with the land.' This implies a misconception of the supposed case. It is the intending builder who is considered, and therefore, the question may be answered thus—because, otherwise, his site will remain vacant. The building owner is not in the weaker position, for his building is *not* yet on the land. In respect to existing leases there is no room for shifting between the building owner and ground owner, and when a lease has expired, the ground owner absorbs the building owner's interest, or, as Professor Seligman puts it, 'the building under the law goes with the land.' Cp. the statement 'this freeholder is generally spoken of as the "ground landlord," but . . . is in no sense more the owner of the ground than of the house . . . At the expiration of the lease both land and house revert to him together.' *Report of Town Holdings Committee*, vi. vii. This position is fully accepted by Lord Balfour and his co-signatories in the separate Report on urban rating and site values. Commission on Local Taxation, *Final Report*, 154. A slight alteration in the text meets Professor Seligman's other objection, viz. 'that there is no such thing as a strict monopoly value of a lot.

be that in the influence of taxation we have at least a partial explanation of two important economic facts: (1) the curious local diversities of prices, and (2) the failure of various local industries.[1] The creation of various interests makes the matter more complex. Between the ultimate owner of the soil and the immediate occupier there are often, as already noticed, several intermediate interests, and the house and building taxes may be placed on them in different degrees. The tenant, free to leave, can, if the economic conditions favour, throw back his taxes, but the leaseholder cannot. For this reason legislative provisions are urgently required to secure a due division of burdens that the process of shifting cannot fairly distribute, and the problem of devising a fair house tax is made more difficult. Division of rates between occupiers and owners is an old proposal tending in this direction. More radical is the plan for taxing ground rents, either by a special charge imposed on them or by the method of deduction, the holder of each interest retaining the amount of the tax on the payment made to his immediate superior.[2] The policy of confining general taxation of land and houses to their contribution in common with other kinds of revenue to an income tax appears to be the soundest. Local finance is thereby supplied with a special kind of taxes and the question of unequal valuation between localities is reduced in importance.

§ 6. The taxation of land and buildings covers most fixed capital. Many doubtful points may arise as to the treatment of machines and fittings, but they usually come in connexion with the taxation either of mines (a form of land)

[1] Fawcett, *Political Economy* (5th ed.), 626. His argument as to the incidence of rates on the consumer is based on too rigid an interpretation of the doctrine of equality of profits.

[2] The latest scheme in this direction is that of a section of the Local Taxation Commission for a special charge on site values. This charge is to be divided between owner and occupier, the latter deducting one-half the tax from his payment. See *Final Report*, 153–176. More extreme plans are vigorously criticised in this Report.

or of factory buildings, and are taken as part of a general property or income tax, or come in as indications to be used in the taxation of business. Proposals to tax fixed capital as such have been made, but they have not as yet been reduced to practice. Apart from the taxation of land and buildings and the taxes on particular commodities, we have next to examine the taxation of floating capital.

The question of a tax on interest presents itself in practical finance chiefly as to dividends and mortgages. They represent the great mass of wealth that is invested by its owners for gain without their direct supervision. Floating capital as such is so closely combined with other elements and is so hard to trace, that its separate taxation is scarcely ever presented. Unless this large part of wealth is reached in some way there is an undue encouragement given to it. Investments in land and industrial enterprises are checked, and the distribution of taxation is so far unfair. These reasons point towards the adoption of the general income tax, which will necessarily include the revenue from floating capital.

The separate taxation of floating capital for general or local purposes in a direct form is not found in England, but Schedule C (and part of D) of the income tax discharges this function, and loans in the form of mortgages come under Schedule A. The yield of Schedule C for 1900–1 came to £1,671,000. The taxes on acts are of service, as they compel these forms of wealth, so difficult to be reached by direct means, to contribute to the revenue.

France has employed a substitute for this part of the income tax in the *Impôt sur les valeurs mobilières*, introduced in 1872, by which 3 per cent. was imposed on the shares of companies either home or foreign ; the yield, which in 1873 was £1,250,000, increased by 1880 to nearly £1,600,000 : by 1890 to over £2,000,000. The rate was raised to 4 per cent. in 1890, and the estimate for 1902 is £3,130,000, or nearly double the receipts of 1880.

Italy, like England, reaches interest by means of a general

income tax, and such is the usual method. In fact, one of the strong reasons for its introduction is precisely the desire to make capital contribute its due share. In some of the South German States a special capital tax has been developed. Bavaria has a capital tax besides its income tax, and both Würtemberg and Baden have somewhat similar imposts.

The great objection to a separate tax on the yield of capital is the extreme difficuty of making it effective. The necessary result of the ease with which it is escaped is injustice in its distribution. The French tax on *valeurs mobilières* falls on the shares of companies ; it is analogous to a corporation tax and tends to discourage those associations. Investments abroad are much more easily kept out of the tax collector's ken, and thus the progress of home investments is checked. On the whole the reasonable conclusion is that the distinct tax on interest has no place alongside of the land, building, and business taxes that form so large a part of the fiscal receipts.

Its incidence, which in the case of a complete and comprehensive tax on interest is on the holders (unless in so far as the supply of capital is checked by the lower returns), is affected by the partial form that it usually takes. A tax on, *e.g.* mortgages lowers the profitableness of that particular kind of lending, and will therefore force the mortgagors to pay at a higher rate under the penalty of getting a less amount of accommodation. Thus the incidence will probably be partly on landowners requiring loans, partly on capitalists in general, as some of the capital that would have gone to land will seek other outlets and lower the rate in them. The same reasoning applies to other similar cases—taxation of corporations or any special use of capital. The question, already noticed in connexion with land, of the wiping out of the tax by the sacrifice of the capital of the original holders presents itself here. Stocks or shares subject to a tax must sell for less than if they were free from it, and it may be thought that the transactions of the

Stock Exchange speedily discount these public charges and estimate the taxed shares on their *net* revenue. In dealing with this case two considerations deserve notice, (1) the ever present possibility of the repeal or alteration of the tax, and (2) the extent to which other primary forms of revenue are burdened with like charges. If revenue from land, buildings, capital, and personal exertions is all subject to the same charge there can be no depression of their relative values. The so-called 'throwing off' (*Abwälzung*) of taxation means simply that taxation as a whole is a deduction from the resources of the country where it is imposed.

§ 7. The scantiness of direct and special taxation on loan floating capital is further accounted for by the greater prominence of industry as an object for the financier. Pure interest is not so readily taxed as profits; the older English writers have in fact preferred not to separate this compound element of income. Taxation of profits takes the joint yield of capital and business ability for its object, a course justified by the close connexion that exists in reality. The financier must deal with external characteristics, and, as rent has to be taxed through land, so have earnings been selected as a mark for imposition in preference to the more refined elements of interest and employers' gains. The actual taxes on industrial receipts may indeed include the several factors of rent, interest, wages, and employers' gain, since both land and labour may contribute to the creation of what is popularly and legally described as 'profit.'

The original form of this taxation is found in the licenses for trade so common in earlier times. Traders who at first were supposed to pay the import and export duties imposed on their commodities were besides subjected to duties for pursuing their particular avocation. The whole mediæval system of incorporations and guilds, which survived till the French Revolution, placed certain burdens on those engaged in industry, and the modern 'tax on business' may regard

this as its precursor. Within the present century there has been a marked development of this form of taxation, influenced very much by the French system to be presently described.

Some very difficult questions are raised by the taxation of profits, questions that it is to be feared can in practice admit of only a partial solution. Foremost of these is the ascertainment of the actual amount earned. Valuation of land and of buildings is a complicated and expensive process, but it is light compared with the task of measuring the fluctuating gains of industrial production. It would sometimes be impossible for the taxpayer himself to say what were his gains in a given year, but a greater difficulty lies in his unwillingness. The unchecked declaration of the contributor is quite ineffectual, while official assessment involves a considerable amount of arbitrary interference with private affairs. Taxes on industry and profit as distinct from a general Income Tax are usually based on certain legal presumptions. The letting value of the area occupied, the character of the business, the number of persons it employs, the population of the district in which it is carried on, may be used separately or in combination as indices of taxable capacity. None of these tests can be expected to give an exact result, but their use tends to obviate the dangers of fraud on the one hand and inquisition on the other. Productiveness and a tolerable approach to just distribution are the two essentials in taxation: the unfairness that the use of presumptions must more or less cause is on the whole a less evil than the encouragement to dishonesty that self-assessment gives. Moreover the gains of industrial occupations are now too large a part of the national revenue to be allowed to escape taxation without causing greater injustice than their exemption would remove. Profits hold the place that land revenues formerly occupied.

§ 8. The actual taxation of profits in England apart from the license duties on particular trades and occupations is

carried out by Schedule D of the income tax. The former element is a small one, and is mixed up with various direct taxes on consumption. Thus out of £3,900,000 received for the local authorities in the year 1900–1 on account of licenses, £1,640,000 belonged to taxes levied on consumption, leaving £2,250,000 for industrial taxation, which, as the total return of licenses has not within the last twenty years varied more than 3 per cent., we may take as representing the normal contribution from this source.[1] Schedule D, which at the rate of 1*s.* 3*d.* gives a yield of £16,400,000, is the main tax on profits; but to it the taxation of farmers' profits under Schedule B should be added, though the latter has some points of connexion with the strict land tax under Schedule A, since the assessment is based on the rent,[2] and the real incidence of the tax is not clear. The yield from this Schedule is not more than £223,000. We thus get a total taxation of nearly £19,000,000.

§ 9. The French system of taxation of profits commenced with the law of March 1791.[3] One of the first measures of the Constituent Assembly had been the abolition of the restraints on industry, and no intention of taxing it otherwise than through the general tax, which the *mobilier* was intended to be, existed. Fiscal necessities forced the establishment of the *Droit de Patente*, which, like the *mobilier*, was estimated on the letting value of the establishment, the tax to be 10 per cent. for rentals under 400 livres, 12½ per cent. for those between 400 and 800, and finally 15 per cent. for those above 800 lives. Abandoned in 1793, it was restored in a different form in 1795. Subsequent changes in 1796–7–8 established the outlines of the present system, which has, however, been developed by a

[1] Some small licenses on manufactures have been retained by the central government, viz. brewers, distillers, tobacco manufacturers, and medicines.

[2] One-third of the rent is now taken as the profit of the farmer, who, however, if he prefers, may be assessed under Schedule D. Previous to 1894 one-half the rent was the standard in England and Wales.

[3] Under the *Ancien Régime* industry was taxed through the personal *Taille* and the *Vingtièmes*.

series of later measures.[1] The tax applies to all occupations and professions not specially exempted. It is divided into a fixed and proportional duty, and, unlike the other direct taxes, it is 'rated,' not 'apportioned.' Of its four classes or 'tables,' one (D) is imposed on salaries; the others embrace the various kinds of trades. The so-called 'fixed' duty is really graded. For the first class (Table A) its amount depends on (1) the kind of trade and (2) the population of the *commune* in which it is carried on—*e.g.* a trader in the first group of Table A in a *commune* with over 100,000 inhabitants pays £12 (300 francs), one in the eighth group only 10*s.* (12 francs). Were they in a *commune* with less than 2,000 inhabitants they would pay 28*s.* (35 francs) and 1*s.* 8*d.* (2 francs) respectively, and the latter would be exempt from the proportional tax. In the second class (Table B) special rates are laid down, ranging from £80 to £1, according to business and population of the *commune*. The third class (Table C) has a fixed duty for each trade, with additions for each workman employed.

The proportional duty is a certain percentage on the letting value of the trader's residence and establishment, varying from 10 per cent. to 2½ per cent. on the first class, 10 per cent. on the second, and in the third varying from 6·60 per cent. to 2 per cent., imposed at different rates on residences, warehouses, and factories. Thus a pin manufacturer who falls under the third group of Table C pays 18 francs, plus 3·60 francs per workman employed, 5 per cent. on his residence and separate shop, and 2½ per cent. on his factory. A Paris banker (Table B) pays 2,000 francs and 10 per cent. on his house and bank.[2]

The object of this very complicated system is evidently to escape the arbitrary pressure of officials. External

[1] Most important is the law of 1844, amended in 1853, 1872, 1880, and 1893.

[2] For the *Patente* see Vignes, i. 52–53, ii. 333–380; Leroy-Beaulieu, i. 393–414; Wagner, iii. 468–489.

marks supply the materials for assessment, and prevent the honest from suffering through the evasions of other tax-payers. There is in addition an advantage given to the more successful producers and traders, as their extra gains are free from taxation. The State assumes that, in a given situation, so much profit will be made, and taxes accordingly; any defect or excess concerns the trader alone.

Certain gaps in the *Patente* tax are noticeable, especially that caused by the absence of agriculturists. The farmer is free from this tax; his profits do not contribute to the services of the State. The *Impôt foncier* is a tax on rent in the main, and cannot be regarded as counterbalancing the taxation of industrial profits.

In spite of its complication, inequalities, and failure to include agricultural profits, the *Patente* has the two great advantages of being productive and not very unpopular. As a contribution to the State it has risen from less than £1,000,000 in 1830 to over £2,000,000 in 1860, over £3,000,000 in 1880, and £5,200,000 in 1900. The additional *centimes* for local purposes have grown from being under £30,000 in 1830 to £900,000 in 1860, £2,200,000 in 1885, and £2,680,000 in 1900. With the small extra items there is thus a total amount of over £8,000,000 obtained from this source.[1] Licenses are also used in the French financial system, but their return, under £500,000 in 1883, was only slightly over it in 1889. To these should be

[1] More accurate figures are—

FRANCS (000's omitted).

	Principal.	*Additional.*	*Total.*
1830	23,047	5,209	28,256
1860	48,508	31,621	80,129
1880	79,009	85,597	164,606
1885	81,381	90,535	171,916
1890	83,844	95,874	179,718
1895	86,680	103,235	189,915
1900	91,937	114,182	206,110

The additional *centimes* include those for State purposes, which amounted to 20,200,000 francs in 1885 and to 39,000,000 francs in 1900.

added the duty on mines, which does not amount to £100,000.

§ 10. Italy, as already stated, has followed England in adopting the income tax. Profits come under Schedule B, which comprises 'mixed revenues' as distinct from those due to capital or personal action solely, and their taxation is very imperfectly carried out. Profits are taxed at one-half only of their amount.

The German States developed a tax on industry (*Gewerbesteuer*), probably suggested by the French *Patente*. The Prussian tax was established in 1810, and modified after the French war in 1820. Further alteration took place in 1843, 1861, and 1872. It grouped contributors into three classes: (1) traders and manufacturers, (2) hotel and inn keepers, and (3) hand-workers who employ assistants. The rate of duty varied according to the population, there being four different scales. A medium rate was fixed for each trade on this basis, and the total amount for the district (arrived at by multiplying the medium rate by the number of contributors) is redistributed by the local authorities. Some industries were specially charged, while agriculturists and the professional classes were exempt. In 1810 it returned only £90,000, by 1864 it had risen to £580,000, and in 1887–8 to £1,000,000—*i.e.* less than one-sixth of the *Patente*, or of Schedule D. By the law of 1891, which came into force in 1893, the structure of the tax was altered, and while the method of grouping was retained, the amount of product and the capital employed became the principal elements in arrangement. Contributors are grouped in four classes, the highest consisting of those with a product exceeding £2,000 or a capital over £50,000. The later legislation of 1893 provided for the transfer of the reformed business tax from the domain of state to that of local taxation.[1]

[1] For the Prussian *Gewerbesteuer*, Cohn, § 307; Wagner in Schönberg, 273; also *Finanzwissenschaft*, iv. 18, 20, 31, 32, 41; *Taxation of Personal Property* (Misc. No. 2, 1886, C. 4909), 8–10. For the recent changes see

The secondary German States have been influenced by the example first of France and later of Prussia. Saxony since 1874 has used the general income tax as the method of taxing industries. Bavaria, Würtemberg, and Baden have employed a special trade tax (*Gewerbesteuer*), on the model of the French *Patente*. The recent tendency, however, is in the direction of the general income tax. As yet Bavaria and Würtemberg have not adopted this form, but retain the produce taxes in a developed shape.[1]

Austria also employed a trade tax yielding a revenue of about £1,000,000 annually until the reform of 1896, by which a system of taxation equivalent to an income tax was introduced. The product of the 'industrial' and 'company' taxes in 1900 amounted to £3,400,000.

§ 11. In the United States the taxation of industry by the Federal Government has been confined to occasional licenses on some trades. Nor have the 'States' gone further in this direction. One increasingly important section of industries has, however, received special treatment, viz. the public companies that have been so largely developed under the liberal provisions of American commercial law. The corporation tax is in the main an American institution, and its growth is instructive both for the economist and the student of finance.[2] Regarded from the economic point of view, the corporation is a means of distributing income to its members, and therefore taxation imposed on it falls on some or all of the classes that receive from it. Viewed as a business tax, the great defect of this impost is its inequality. It selects one form of industrial undertaking and penalises it. The amount of the penalty indeed varies with the particular form of the charge, which

Wagner's article in *Finanz Archiv*, xi. 1–76, and J. A. Hill, 'The Prussian Business Tax,' *Quarterly Journal of Economics*, viii. 77–92.

[1] See on these States Wagner, iv. 830–46, where the latest changes are noticed. For Bavaria see Schanz, 'Das Bayrische Ertragssteuersystem,' *Finanz Archiv*, xvii. 551–772.

[2] See Seligman, *Essays*, 136–264 (chs. 6, 7, 8), for a history and discussion of this tax

may be imposed on business transacted, on capital value, on gross receipts, or on net earnings,[1] but the defect is to be found in all these forms, though as between different corporations the last mentioned basis is unquestionably the right one. Perhaps the best plea for the tax is that it, to some extent, relieves the property tax, which has even greater defects. Scientifically considered, the corporation tax is an imperfect business tax, just as the latter is but one section of a true income tax.

§ 12. The principal features of the taxation of profits, as actually carried out, show that two alternative methods are open. Either the taxpayer may be assessed on his (supposed) real net receipts, or certain external indications may be taken as a guide. The former is generally found where profits are taxed through a general income tax. England and Italy supply us with the leading examples. The difficulties in the way of arriving at the true net profits have hindered other countries from completely following this course. The French method has seemed, if less equitable in the abstract, yet in reality fairer. It does not, in Mill's phrase, 'tax conscience.' Nevertheless there is a cumbrousness and, in part, a want of elasticity about it. The long lists of trades coming under the *Patente*, with the great varieties in the permanent and the proportional charges, must add to the labour of administration. Its inequalities must also be great. Neither the population of the district nor the rent of residence and business premises can give anything more than a faint presumption of profits. The *Patente* is very far from being a proportional tax on industrial gains. It rather resembles a charge on certain necessaries of the business, such as buildings, labour, or motive power. It accordingly marks a lower stage in the development of taxation. The fair assessment of profits may be at present beyond the power

[1] For a full enumeration of the bases of the corporation tax see Seligman, *Essays*, 176–9. The most important are those given in the text; see also Adams, *Finance*, 449–466.

of financial administration, but efforts should be made in that direction. It may be suggested that the external marks, which are now regarded as conclusive, should rather be used as presumptions, whose weight will be affected by other conditions, and it is probably by this method that advance will actually be made.

Another noticeable feature of the Continental taxation of industry is its aid to local revenues. The £2,500,000 that the *Patente* gives to the French departments and *communes* is paralleled on a smaller scale in the case of Germany. There the local revenues are recruited partly by additions to the direct taxes, and, with some exceptions, this applies to the taxation of industry.[1] Austria follows the same method, by which a branch of income that is free in England is compelled to contribute to the public revenues of the locality in which it is situated. We have already seen reason to reject the plan of taxing income, or its separate parts, locally, and it appears better to use the license system for the purpose of recruiting local funds. Thus the *Patente* and licenses in France might be so remodelled as to create (1) a general tax on trade incomes, (2) a considerable local receipt from the 'fixed' part of the *Patente*, in combination with a further development of the existing licenses.

§ 13. The incidence of taxes on industry is not quite so definite as writers on finance often suppose. Pure or economic profit is made up of two distinct elements, and the extent to which the receiver of interest and the earner of employers' gain can shift taxation is not the same. In the actual forms of taxation a proportional tax on profit may cut away more of one element than of the other in different cases. Thus the distribution of the burden between interest and earnings may be unequal, but as regards outsiders, shifting to them can only be effected by the possible check to accumulation of

[1] Cohn, §§ 461–3; Reitzenstein in Schönberg, 623; Fournier de Flaix, 401 seq. For the future in Prussia the industry tax will be altogether local.

capital. Where, however, taxation is not proportioned to pure profit the effect may be very different. It is not hard to understand that taxation so unequal as the *Patente* may drive out some of the producers, and enable the survivors to shift the charge to consumers. The tax becomes one of the expenses of production. Again, the local inequalities may allow of higher gains in some districts, and cause higher prices in others, in which latter case the consumer suffers. Differences between trades may, and probably will, affect the distribution of industry, and thereby cause a diffused incidence too complicated to trace. The same consequences must follow the use of taxes with different rates within a connected area like Germany. Specially heavy taxation in one State may actually, in some degree, increase the profits of producers elsewhere, by raising the price of the commodity within one district; but it is still more likely to press on the producers subject to it.

On the whole, the taxation of industry has not approached so closely to a tax on pure profit as that on land has to a tax on economic rent. This circumstance is partly due to the greater complication of the matter, but also to the less perfect development of fiscal methods.

CHAPTER III

PERSONAL AND WAGES TAXES

§ 1. Older than the taxes that we have been engaged in considering, but now of little importance, are the capitation or poll taxes, so familiar to students of mediæval finance. Their origin is evidently found in the idea that persons, as such, should contribute to the wants of the public power. Capitation and property taxes were the two great categories of receipts in early times. When the greater part of a community possessed little accumulated wealth, the method of taxing each adult for a fixed sum was natural. What is very suitable in a rude state of society is altogether unfitted for a progressive and civilised one. No modern State could employ a capitation tax as a substantial source of revenue. Its inequality and directness combine to make it unpopular. The remains of this form of personal taxation are, however, very general, though their interest is rather historical or political than financial.

The equal taxation of persons by poll taxes or capitations generally develops by some form of graduation into an income tax,[1] or, as happened widely in the seventeenth century, is replaced by an excise on the necessaries of life. The sense of proportion accounts for the former, as the great dislike to the capitation tax does for the latter. But several

[1] It is significant that Adam Smith discusses the income tax under the title 'capitation taxes,' *Wealth of Nations*, 367.

countries, notwithstanding, retain a small charge on the person of each contributor.

§ 2. English history supplies us with some illustrations of the poll tax. The first was in 1377, followed immediately by those of 1379 and 1380 (the latter the proximate cause of the Peasant Revolt). The two latter were graduated according to rank. At intervals the graduated poll tax reappears, as in 1453, 1513, and 1641. Its last employment was under William III. in the French war, and it ceased completely after 1698.[1]

The French capitation was first levied in 1695, and continued with changes up to the Revolution. It was graduated; at first twenty-two classes were formed, but this part of the system was altered in 1701. The constituent Assembly created the personal tax (1791), which consisted of the value of three days' labour, and added it to the *mobilier*. The price of the day's labour is determined for each *commune* by the Council of the department, within the limits of 5*d.* and 1*s.* 3*d.* No addition can be made for local charges, and where an *octroi* is levied, the personal tax may be paid out of it. So far as can be ascertained, the total yield is between £600,000 and £700,000.[2]

The Italian States possessed complicated capitation taxes which have not survived the establishment of the present kingdom. So did many of the German States;[3] of which, the class tax of Prussia was the most noticeable. The poll tax of 1811 was replaced by the class tax of 1820 by which the mass of the population was grouped in four classes, paying various rates, from £1 16*s.* to 9*d.* The income tax and the class tax were separated in 1851, and the latter, confined to incomes under £150, was divided into twelve classes, which, under the law of 1875, paid from 3*s.* to £3 12*s.*, incomes under £21 being exempt. By the law of 1891 the class tax was absorbed in the income

[1] Dowell, iii. 3–7. [2] Vignes, i. 40–1.
[3] De Parieu, i. 139–151.

tax, and incomes under £45 are exempted. The Saxon income tax in its lower part is practically the same as a capitation tax. The poll tax also survives in Switzerland, where it is chiefly employed for local purposes, and not in all the cantons.

Russia, which had long preserved the capitation, abandoned it in 1887. The nobility had been always exempt, and, since 1866, the commercial classes. While it was in force the rate varied from district to district, and its amount was about £9,000,000 (taking the rouble at its nominal value).

In the United States poll taxes have been used from the colonial period. At present, more than half of the States have them in force, mostly for the state or commonwealth revenue, but, in some cases, for the counties, and in others for education, or road making. In some commonwealths the payment of the poll tax is a condition of the suffrage.[1]

In addition to the taxes already noticed, we should mention the services demanded by the State from its citizens. Military service is the most prominent, and it is a large part of the real, as distinguished from the nominal, cost of Continental armies. The real nature of this service, as a tax, is best shown by the compensatory tax (*Wehrsteuer*), imposed on those who do not serve, which has given rise to so much controversy in Germany.

The method of *Prestations* in France for the repair of roads is another example, and there too the alternative of working or paying is open. The mediæval system of finance availed itself more extensively of this direct method of procuring resources; the surviving instances in modern times are—with the exception of military duty—more curious than important.

§ 3. The poll or capitation tax is far from being a pure tax on wages: the taxation of professions through

[1] Seligman, *Finance Statistics of American Commonwealths*, 53; cp. Ely, *Taxation*, 209 ff. This was the case in Massachusetts until the amendment of the Constitution in 1891, *Massachusetts Tax Commission Report* (1897), ;

Schedule D of the English Income Tax, and by the fourth division (Table D) of the *Patente*, is a nearer approach to that point. Attempts to reach the great body of wage-earners are generally made by means of indirect taxation. The enforcement of a capitation tax is certain to meet with, at least, passive opposition, and in any case its productiveness cannot be great. The method of using it as a necessary condition to acquiring full political rights may be admissible if the receipts are given to local bodies, but this regulation is political rather than financial.

The general result is that this form of taxation is decaying. Its persistence is due to the financial conservatism that is so strong in most countries. It is altogether out of place in the modern financial system, and though it may for a time survive in some Swiss cantons or American States, its importance will, we believe, steadily diminish.

The incidence of personal taxes, especially in the form of capitations on day labourers, has been regarded by many writers as wholly on the employers, or through them ultimately on the consumers of the products they turn out, but this conclusion is not by any means certain. It is far more probable that a small tax on the poorer classes will lower, or prevent a rise in, their mode of living. Its action on population is far too indefinite to be used for laying down an absolute rule. Much will depend on the exact form of the tax, whether uniform or graduated, confined to the head of the family or extended to its other adult members. No proposition in finance has been more dangerous in its application than that which declares that the labourer cannot permanently suffer from taxation.[1]

[1] Lord Avebury (*Statistical Journal*, lxiv. 567) regards this passage as 'an admission which amounts almost to a surrender' of the position taken with respect to the theory of equal diffusion in an earlier part of this work (see Book iii. ch. 5, § 4). It is, however, merely a criticism of the exaggerated form of the doctrine held by the Physiocrats and Ricardo. To hold that labourers do not always, or even generally, shift capitation taxes is quite consistent with believing that taxes are not equally diffused.

CHAPTER IV

TAXES ON PROPERTY AND INCOME

§ 1. At the opposite extreme to capitation or personal taxes are those that are imposed on property. The antithesis between 'persons' and 'things' or, in economic language, between services and commodities, is apparent in the earliest stages of society. When the period of contributions in kind is passed, the first objects of taxation are the persons and property of the subjects. The property tax is probably older than the separate charges on the yield of land, or capital, or even labour; the sum of existing wealth is an easier, though not so fair an object for imposition. Land, slaves, and oxen—the *res mancipi* of Roman law—with household goods generally are the commodities that first fall under taxation: they are on the spot, easily estimated, and in most cases proportioned to the land under cultivation. As society advances and new forms of wealth come into existence, the injustice of the old system becomes evident, and taxation is extended to movable property, either by special taxes, or, more generally, by including it in the category of taxable objects. The difficulties in the way turn out to be too strong: personal property gradually escaped from the duty of contributing.[1] Such seems to have been the fate of the property tax wherever it has been tried; in ancient Rome, in the various attempts in England, as also with the French *Taille* and the later *Dixièmes* and *Vingtièmes* of the eighteenth century.

[1] In Mr. Dowell's words 'personal property slipped out of assessment,' iii. 85; see also Cannan, *History of Local Rates*, for the limitation of rates to immovable property.

This very general tendency to disintegration in the property tax is partly due to its economical defects, partly to technical difficulties in its administration. As regards the former there can be no doubt that, speaking generally, the property tax is merely a form of assessment, the payment being really made out of income. Taxation that falls on capital in the strict sense must diminish the sum of the community's wealth, a process that cannot continue indefinitely. In using property as the basis for taxation there is always a danger of trenching on the accumulated resources of the society. A second obstacle lies in the fact that property is not really a fair gauge of taxable capacity. Some forms of wealth give a lower return than others, and in special cases may even involve outlay. If, as we saw,[1] income or revenue is on the whole a satisfactory standard for taxation, a property tax, unless carefully balanced by other charges, is unjustifiable. It is the result of a confused idea as to the true measure of taxation.

The technical difficulties result from the nature of property. In many cases it is only an abstraction obtained by capitalising revenue. This is pre-eminently true of the great mass of property in which the modern stock exchange deals. Shares of companies and public debts are only of value in consequence of their revenue, and their capital value is reached by a process of estimation; it is besides constantly varying in a way that does not allow of precise measurement. Income is a definite receipt during any given period, and is therefore a better object for charge. The difficulty of reaching the multifarious forms of personal property is a further objection. To arrive at the amount of taxable wealth and to assess it fairly is quite impossible. The 'slipping away' that always takes place leads to grave inequalities and injustice. The owners of certain forms of wealth are unduly burdened by having to pay the share of those who have evaded their duty. These are sufficient grounds to justify the very general abandonment of the property tax as a leading source

[1] Bk. iii. ch. 3, § 13.

of revenue.[1] Taxes on produce (*Ertragssteuern*), such as those discussed in preceding chapters of this book, take its place or survive it, while they in turn tend to develop into the income tax.

§ 2. The property tax has, however, maintained its ground in two countries. Switzerland still possesses, but in most instances with great modifications, this ancient method. Though the central government does not avail itself of the property tax—except in the charge for military exemption—all the cantons employ it. The forms adopted are varied, complex, and often changed.[2] Their characteristics will be best understood by taking a single canton and examining its system. That used in Zürich divides property-holders into classes. The lowest, those under £800, pay on one-half only; the second, those between £800 and £2,000, pay on one-half of £800, and on three-fifths of the excess. Between £2,000 and £4,000 taxation is imposed on seven-tenths of the excess over £2,000; between £4,000 and £8,000 on four-fifths of the excess. For property under £16,000 only nine-tenths of the excess over £8,000 is charged, while any amount over £16,000 is charged at its full value.[3] Under such a scale the smaller properties escape very easily. The Zürich method is modified in other cantons. In Graubünden

[1] But see § 4, *infra*, for the partial revival of this tax; also cp. Bk. iv. ch. 9, for inheritance taxes, which are closely akin to sudden charges imposed on property.

[2] The total mass of legislation and legislative proposals is quite overwhelming. It has been collected with characteristic thoroughness in the elaborate work of Schanz, *Die Steuern der Schweiz* (over 2,000 pages in 5 volumes).

[3] The following table will show the rates of charge—

Property.	*Sum chargeable.*
£	£
400	200
800	400
1,200	640, *i.e.* ½ of 800 and ⅗ of 400
2,000	1,120, *i.e.* ,, ,, of 1,200
4,000	2,520, *i.e.* $\frac{7}{10}$ of the extra 2,000
8,000	5,720, or ⅘ of the extra 4,000
16,000	12,920, or $\frac{9}{10}$ for the extra 8,000
20,000	16,920, the extra 4,000 being all charged,

the lowest class is charged at the 'simple' rate; in the next class 10 per cent. additional is placed on the entire property; in the third 20 per cent., and so on till in the eleventh class the rate is double. The more primitive canton of Uri has a higher rate of progression; from $\frac{1}{20}$ of 1 per cent. on property under £1,200, it rises to $\frac{3}{20}$ of 1 per cent. on properties over £16,000. The town canton of Bâle makes but three classes: $\frac{1}{20}$ of 1 per cent. is paid by estates under £4,000; $\frac{3}{20}$ of 1 per cent. on those between £4,000 and £8,000; and $\frac{1}{5}$ of 1 per cent. on those over £8,000. In some cantons there is no progression, all properties being taxed at the same rate. Communal taxation is also in many cases levied on property, but it is rarely progressive (*e.g.* in Zürich *communes* are forbidden to impose a progressive rate), and generally moderate in amount.

The Swiss system of property taxation suggests several points of financial interest. Though a long-established form, it has been gradually adjusted in accordance with modern ideas, and is used to supply gaps in the other kinds of taxation. The aim of taxing permanent incomes at a higher rate is accomplished by a tax that does not touch pure earnings. Non-revenue-yielding wealth is also reached, and the democratic ideal of reducing the burden on the smaller incomes is in some degree realised. But notwithstanding this tendency, the rates are so moderate that the effect on capital is hardly perceptible. Evasion perhaps accounts for a good deal of this indifference on the part of the wealthy, and shows that the administrative system is far from perfect. Again, the very narrow areas within which the several systems are applied, and the smallness of the populations affected, make the operation of the taxes more difficult to use for generalisation.[1] They

[1] The following are the areas and populations of the cantons referred to—

Canton.	*Area. Square Miles.*	*Population.*
Bâle (town)	22	73,749
Graubünden	2,774	94,810
Uri...	415	17,249
Zürich	665	337,183

are, in fact, a remarkable form of local taxation, and should be so regarded.

§ 3. One of the many points of likeness between the American States or 'Commonwealths' and the Swiss Cantons is their use of the general tax on property. But on closer examination the special differences are more important than the general resemblance. The American tax is not in any case progressive, and is rarely accompanied by anything resembling an income tax. Another feature of difference is the apportionment system adopted in the United States. A given sum has to be divided over the several counties of a State in proportion to their assessment, and the valuation of property is in consequence put by the county officials at the lowest figure admissible. The system adopted in Ohio may serve as an illustration of the general methods. By a constitutional provision all property (with some insignificant exceptions) must be taxed. To carry out this law real property is valued once in ten years by assessors appointed for the purpose, who are to take each plot 'at its true value in money.' As the assessors in each county compare results they are probably uniform, but as between different counties there is often great difference, which is corrected, though imperfectly, by a board of equalisation. For personal property an elaborate series of queries is issued to each adult, who is bound to answer them, and to swear to the truth of his return. The number of cattle, watches, pianos, merchandise, money, stocks, bonds, &c., have to be declared, and their selling value stated.[1] Nothing could apparently be more searching and effective. Other States possess tax laws quite as rigorous. In Georgia both land and personalty are included in the queries issued, which, moreover, contain a question as to evasion. Unfortunately the universal experience is that the greater part of personal property is not returned. Assessors' reports, Governors' messages, and reports of tax commissions all dwell on this fact. The

[1] The above account of the Ohio property tax is condensed from Ely, *Taxation*, Pt. ii. ch. 4, which gives full details.

New York report of Mr. Wells in 1871 is quite in agreement with the Maryland report of Professor Ely in 1886 while Professor Seligman declares emphatically that 'the general property tax as actually administered to-day is beyond all doubt one of the worst taxes known in the civilised world.'[1] The reasons for this general condemnation are not far to seek. They are, first of all, lax administration. Officials elected for short terms cannot be expected to scrutinise very closely the answers of their constituents. Palpably inadequate returns are accepted with little question, and the wealthiest get off best. A second cause is the local nature of the property tax, as compared with the national, or even universal movement of the finer forms of personal property. Bonds and shares are easily moved outside a State during the time of assessment, and more obvious forms of capital have to be leniently treated to avoid their emigration. Mr. Wells has pointed out very forcibly the discouragement to capital that the New York system gave,[2] in contrast with those of Pennsylvania and other adjoining States; but in practice the pressure is very slight. One fact suffices to establish the defectiveness of the property assessments. It is the decline in the declared value of personal property during a period in which wealth has beyond question increased enormously. The personal property in New York State in 1869 was assessed at $434,000,000, in 1875 it had fallen to $407,000,000, and in 1885 to $332,000,000, *i.e.* a decline of over $100,000,000 in the commercial centre of the Union. The similar figures for real property are, for 1869 $1,532,000,000, for 1875 $1,960,000,000 and for 1885 $2,762,000,000, or an increase of nearly $1,230,000,000.[3]

[1] *Essays*, 61. The recent Ohio Tax Commission is equally emphatic. 'The system as it is actually administered results in debauching the moral sense. It is a school of perjury. It sends large amounts of property into hiding. It drives capital in large quantities from the State,' *Report*, 24.

[2] *Report on Local Taxation*, 17–18.

[3] Quite as striking is the case of Cincinnati. The following figures give

The defects of the American property tax are, it would appear, beyond remedy, and therefore it may be anticipated that it will in the future be transformed into a land tax with additional charges on other selected receipts, and perhaps finally into an income tax.[1] We may, however, conjecture that a system of state income taxes will also fail owing to the difficulty of localising income. The conclusion already reached [2] that the income tax is best suited for the national government applies fully to the United States. The most promising sources of state revenue seem to be land and license taxes.[3] But whatever be the new forms adopted the property tax is decisively condemned.[4]

§ 4. Notwithstanding the weight of past experience, there has been during the last few years a distinct reaction in favour of the taxation of property. Democratic sentiment

the amounts assessed to realty and personalty respectively at three different periods—

Year.	*Realty.*	*Personalty.*
	$	$
1867	66,454,602	67,218,101
1868	68,559,040	68,412,285
1892	144,208,810	44,735,670

We thus see that while real property has more than doubled in value, the personal property returned is roughly about two-thirds of what it was twenty-five years previously. For further details as to evasion see the excellent *Report of the Tax Commission of Ohio* (1893), especially 24–31.

[1] The Massachusetts Tax Commission, while recognising certain of the advantages of an income tax, declines to recommend its adoption. See *Report*, 85–7.

[2] Bk. iii. ch. 6, § 3.

[3] The best American authorities approve of the corporation tax as a peculiarly suitable form of revenue for the States. Thus Prof. Adams concludes that 'in view of the peculiar duties imposed upon a State, and because of the nature of corporation and natural monopolies, that all special and corporation taxes should be assigned to the State as an exclusive source of revenue.' *Finance*, 502.

[4] On the whole subject of the property tax see the *Local Taxation Report* of Mr. Wells and his colleagues, made in 1871; Professor Seligman's chapter, 'The General Property Tax,' *Essays*, 23–61; his *Finance Statistics of the American Commonwealths*, 53–66; and Professor Ely's *Taxation*, 146–201, in which a mass of evidence is collected showing the grievances that arise from the property tax. Professor Ely, however, fails to notice that the same arguments may be urged against the state income taxes advocated by him in a later part of his valuable work (287–311).

and the latest financial theories have conjointly supported the reintroduction of a charge on realised wealth as such. The most important instances of the actual adoption of this policy are supplied by Prussia and Holland. In the former country there has been an extensive recasting of the revenue system, which has as one of its salient points the imposition of a tax on property. It should, however, be noticed that this new tax is closely connected with the reform of the income tax,[1] and is expressly described as a supplementary tax (*Ergänzungssteuer*). Its functions, according to its promoters, are (1) to impose heavier taxation on 'funded' property, (2) to cover the gaps left by the income tax, and (3) to put the financial position on a sounder basis.[2] The rate chosen is moderate, amounting to about one mark for each 2,000 marks of property, or to one shilling for £100.[3] Consequently the anticipated yield for the first year of levy, 1895–6, was 35,000,000 marks (£1,750,000). The actual receipts in 1897–8 were £1,555,000 (31,100,000 marks) in 1899–1900 they reached £1,680,000. Now this, as we shall see, is less than 20 per cent. of the return obtained from the reformed income tax, and hardly seems enough to justify the employment of an intricate and complicated system of taxation.

The Dutch measure, though the outcome of similar tendencies, yet differs in one most important respect. It is intended to be at once an income and a property tax, and is correlated not by a general income tax, but by a profes-

[1] See § 8, *infra*.

[2] See *Finanz Archiv*, x. 370, where the reasons for the measure are given at length.

[3] The precise rates are :—Property under 6,000 marks is free ; between 6,000 and 24,000 marks the tax rises from 3 marks to 12 marks, at the rate of 1 mark for each complete increment of 2,000 marks. Between 24,000 and 60,000 marks the increments are 4,000 marks and the increased duty 2 marks. Between 60,000 and 200,000 marks the increments and increased duty are 10,000 marks and 5 marks respectively. From that point up to 2,000,000 marks increments and extra tax are doubled. A property of 2,000,000 marks (£100,000) therefore pays 1,000 marks (£50). Every further addition of 100,000 marks involves an increased charge of 50 marks.

sional or vocation tax. It is thus complementary rather than supplementary. A combined income and property tax, in a country like Holland, must necessarily be more productive than a tax on earnings ; and accordingly the estimate of the property tax for 1894 was double that of the tax on professional incomes. In this case too, the rate is not excessive. Properties under 13,000 florins escape altogether. Those a little higher pay two or four florins, according as the excess is 1,000 or 2,000 florins. Higher properties pay one-eighth of 1 per cent., the first 10,000 florins being exempt. Possessions beyond 200,000 florins pay one-fifth of 1 per cent. on the excess.[1] Both the taxes just considered are very slightly progressive, or rather degressive in character, and the Dutch, which, it must be remembered, is intended for both income and property, is the milder. The estimated produce for these taxes for 1901–2 is somewhat under £3,000,000.

§ 5. The failure of property taxes in so many separate cases, and the clearer comprehension of income as the true normal source of taxation, have made the plan of a general tax on revenue or income appear advisable. We have noticed the imperfections and dangers of the single income tax : it is now rather as one of the constituents of a general system of taxation that we have to estimate it. In this aspect we find that the income tax is a distinctly modern product, and one that is likely to grow in importance. A well-balanced financial system will derive a large part of its receipts from direct taxation, as otherwise an approach to just distribution would hardly be possible. Amongst the objects of these direct charges the produce of land, capital, and labour must take their place, and when they have each come under contribution the elements of the income tax are present. The close analogy between the four direct

[1] For the new Dutch system see Boissevain's elaborate study, *Finanz Archiv*, xi. 419–682 (reprinted separately); also Seligman, *Essays*, 322–30. The measures are due to the eminent economist Pierson, and were defended by him on financial, not on social grounds.

contributions in France and the five schedules of the English income tax is evident, and this resemblance extends to the German 'produce taxes.' There is, however one very important difference; the taxes on the several elements of wealth are far less elastic in yield. Thus the French, German, and Italian land taxes have a fixity that is not found in the income tax; and the other produce taxes, though possessing more expansive power, are not yet at all as effective as is desirable: the *Patente* expands more slowly than Schedule D. There are besides various gaps in the most developed of the Continental 'produce taxes.' State creditors in France escape taxation, while the English and Italian fundholders pay on that part of their revenue. Mortgages and other forms of loanable capital also manage to avoid their proper share, which would be impossible with the income tax. But the actual institution of a tax on income is not due to refined considerations of justice: like most imposts, the income tax is the child of necessity. When other contributions have been carried to their productive limit the financier has perforce to fall back on the direct taxation of income. This method is the more necessary in a country where taxation of the several parts of income is absent or inadequate. Both conditions were combined in the case of the first English income tax (1798),[1] and were also present in a great degree in Italy in 1864.

The result of this originating cause is seen in the use of the income tax as a complementary receipt, to be employed in cases of pressure and to meet what would otherwise be a temporary deficit. The aim of keeping a correct balance of expenditure and receipts can be best realised by having a varying income tax adjusted to suit the special circumstances of each Budget. Thus in England the rate has varied from 1*s.* 4*d.* (if we include the earlier

[1] 'It was in this crisis of the revolutionary war that, when Mr. Pitt found the resources of taxation were failing under him, his mind fell back upon the conception of the income tax.' Gladstone, *Financial Statements*, 14.

income tax from 2*s.*) to 2*d.* per pound. Italy has been unable to follow the same course, as the highest rate is in her case requisite in order to procure funds, but the desirability of having a movable tax of the kind is indisputable.

Another advantage of the tax on income is the opportunity that it offers for fairly distributing the burden of taxation. Indirect taxation, and particularly that on consumption, falls with greatest weight on the smaller incomes, and lets the rich escape too easily. An income tax with a suitable scale of exemption goes far to correct this inequality, which duties on acts and inheritances also aid in remedying. Both on financial and equitable grounds there is a strong case for the use of the income tax, not as the sole source of compulsory revenue, but in due proportion with other receipts, and with close attention to the special circumstances of the country.

§ 6. The development of the English income tax throws light on many of the problems connected with its general use. Its history is divided into two periods, (1) that of the war income tax (1798–1816), and (2) that of the peace tax since 1842.[1] The former, preceded by 'the triple assessment,' consisted at first of a tax on the sum of income to be ascertained by the taxpayer's declaration. A lengthy form of return was required, and a number of deductions were allowed, for repairs, support of children, insurance premiums, &c. The yield was about £6,000,000,[2] at the rate of 10 per cent. on the national income, estimated by Pitt at £102,000,000. Repealed at the Peace of Amiens in 1802, it was reimposed in 1803, with the important change of substituting 'particular returns of particular sources of income' for the previous general return. Thus arose the well-known five schedules, and inquiry as to the total

[1] It has twice within this period acted as a war tax, viz. in 1854-56, during the Crimean War, and in 1900–1903 for the South African war.

[2]
1799	£6,000,000
1800	6,250,000
1801	5,600,000

amount of income was avoided.[1] The rate was 1*s.* per pound; incomes under £60 were exempt, and those under £150 taxed at a lower rate. The yield for the first year was over £5,000,000. In 1806 the rate was raised to 2*s.* in the pound, and several changes in the regulations were introduced. The exemption limit was lowered to £50, and the allowance for children withdrawn, also that for repairs, in Schedule A. The method of stoppage at the Bank was applied to Schedule C. With the high rate of charge the yield was at first £12,000,000; in 1815 it had risen to £15,642,000. On the conclusion of peace the Government desired to continue the tax at half the existing rate, but they were defeated and had to abandon it.

The difficulties of English finance during the succeeding quarter of a century were largely due to this mistaken step. The retention of the income tax would have allowed reforms in other branches to have been carried out with comparative ease. Accordingly competent opinion as expressed by Sir H. Parnell and Sayer advised its reintroduction.[2] This prudent counsel was adopted by Peel in 1842. His measure—really the old system with unimportant modifications—was enacted for only three years, and the rate was fixed at 7*d.* per pound (or under 3 per cent.). The yield in the first year was over £5,600,000, the same as at the rate of 10 per cent. in 1801. At its expiry there was an extension to 1848, and again to 1851. It was voted for one year in 1852; in 1853 it was extended to Ireland, and fixed for seven years by Mr. Gladstone, who held out the prospect of 'its relinquishment' at the end of that term. The Crimean war, during

[1] They are—

Schedule A. Owners of land, including houses.
,, B. Farmers, including owners in occupation.
,, C. Fundholders.
,, D. Profits and professions and all other gains unenumerated.
,, E. Public Offices.

[2] See B. Sayer, *On the Income Tax*, 1833; Parnell, *Financial Reform*, 1830.

which the rate rose to 1*s.* 4*d.* per pound, prevented this result, and since 1860 it has been continued as an annual tax at rates varying from 10*d.* to 2*d.* until 1901 when it was advanced to 1*s.*, and then in the two following years raised to 1*s.* 2*d.* and 1*s.* 3*d.* respectively for war purposes. It is now a permanent and, indeed, indispensable part of our financial system.[1]

In studying the English income tax the first noticeable point is its composite character. It is, in Mr. Gladstone's words, 'rather a code or system of taxation'[2] than a single tax. The five schedules may well be regarded as so many distinct taxes, since they deal with separate kinds of revenue. The connexion between them comes out only in cases of exemption or abatement. Inequalities are, however, removed by the comprehensiveness of the tax. Mortgages pay under schedule A by deduction; but there is no inducement to capitalists to put their wealth into the forms included by B, C, or D, as there also they will have to pay on their receipts.

Another important part of the system is the extensive use of stoppage at the source. The result is that a large body of taxpayers never receive the sums due by them to the State. The public funds, dividends, mortgages are all so treated, and evasion and fraud are thereby reduced to a minimum. The separate sources of income are tapped, and supervision is made much easier.[3]

[1] The last time that its existence was endangered was by Mr. Gladstone's proposal of abolition in 1874.

[2] *Financial Statements*, 20.

[3] This method of stoppage at the source has been generally recognised as a characteristic and valuable feature of the English income tax. This is the judgment of Prof. Dunbar (*Quarterly Journal of Economics*, ix. 38–40), Prof. Seligman (*Pol. Science Quarterly*, ix. 644–5) and quite recently of Mr. Hill. The same view is forcibly supported by Mr. Blunden. The only dissentient of note is Prof. Adams, who objects that the principle is carried too far. 'It [the government] taxes the salaries of public officials by not paying them as much as it promised. . . . . The result is the citizen is never sure of getting into his pocket all that he or his property earns' (*Finance*, 479). Further 'it may be questioned if the use made of it by the English income tax is quite honest in its purpose or fair in its results' (*ib.* 484). Two points are raised by this

Thirdly, we may bear in mind the very large yield of the tax. At its commencement it contributed £6,000,000 in a time of great pressure, while its latest service has been as a mainstay of the national finances during the recent war. Its contribution at the rate of 14*d.* per pound for 1901–2 amounted to £34,800,000. The yield derived from the penny per pound is in fact an indication of national progress; from £700,000 in 1842 it has swelled to £2,500,000 in 1901–2.[1]

This productiveness accounts for its great services both in war and peace. It supplied the means for carrying on the struggle against Napoleon, and it rendered possible the reforms of Peel and Gladstone, besides saving the country from deficits.[2]

The extension of exemptions and abatements is a further interesting point. The original limit of exemption (£60) was soon reduced to £50, in order to include the large

criticism, viz., (1) the honesty of the system, (2) its fairness as between different sections. The former seems to anyone actually conversant with the English system almost ludicrous. What is the advantage to the citizen of getting into his pocket what he must immediately pay out again? There would be the necessity for a double transfer of the amount of the tax. So far as public officials are concerned the contention, to give it any substance, should be for exemption from taxation of their salaries. The second point really attacks, not the method of 'stoppage at the source,' but the income tax itself, on the ground that all incomes are not equally discoverable. This is the great difficulty that any income tax must encounter; but it can hardly be held that a contrivance which makes some parts of income more easily ascertainable adds to this weakness. Were all income capable of being taken at the source the income tax would be perfect. An abandonment of the method would increase, not diminish, the inequality inherent in this as in all taxes.

[1] The following figures of income assessed are instructive—

Pitt's estimate,	1798	£192 millions
Amount assessed,	1842	204 ,,
,,	1878–9	578 ,,
,,	1888–9	645 ,,
,,	1899–1900	788 ,,

[2] On the Income Tax see Dowell, iii. 90–120; Hill, *The English Income Tax*. Chailley, *Impôt sur le Revenu*, 89–218, gives a full and lucid account of the English system. The series of studies in the *Economic Journal* by the late G. H. Blunden (whose loss English students of finance must deplore) are most instructive; see vol. ii. 637–52; v. 527–31; vii. 607–18; xi. 156–68.

class who returned their incomes at £59 10*s.*, and £200 was the point at which the full charge was enforced; this also came down to £150 in 1803. Under Peel's measure the exemption limit was placed at £150, and, though subsequently lowered to £100, it was again raised to the higher figure. In 1863 a deduction of £60 was allowed from all incomes under £200; in 1873 this was increased to £80 from incomes under £300; and in 1876 to £120 from incomes under £400. In 1894 the exemption was raised to include incomes of £160; a deduction of £160 was allowed from all incomes between £160 and £400, and an entirely new abatement on £100 for incomes between £400 and £500 was introduced. In 1898 this abatement was increased to £150 while a deduction of £120 was allowed on incomes between £500 and £600 and one of £70 on those under £700.

§ 7. The Italian tax on 'movable wealth' has strong points of resemblance to the English income tax, and has been much affected by its example. It commenced in 1864, when a sum of 30,000,000 lire (£1,200,000) was apportioned among the several provinces, and raised by a tax on revenue (that from land excepted). In 1865 the amount was more than doubled (66,000,000 lire), and in 1866 the tax was changed from an 'apportioned' to a 'rated' one, and the rate fixed at 8 per cent. In 1870 it was advanced to 12 per cent., which, with the additional tenth, levied since 1868, made the total 13·20 per cent., in 1894 it was raised to 20 per cent. Many changes have been made in the methods of levy and assessment. The original law of 1864 has been frequently amended; a new and comprehensive measure was passed dealing with the whole subject in 1877, and a further revision of the classes was adopted in 1894. After the English pattern, the contributors are grouped under several schedules, but the arrangement is different, and used for a different purpose. Class A comprises two divisions, (*a*) revenue from interest on railways and local government loans assessed at its full

value, (*b*) other permanent revenue paying only on three-fourths. Class B contains what are called 'mixed' revenues, or those in the production of which capital and labour co-operate: these escape with payment on one half of their amount. Class C contains revenue from labour, assessed at nine-twentieths of its total. The incomes of public officials are placed in Class D, and pay only on three-eighths of their amount. To these four classes should be added the Metayers as forming a fifth, paying $5\frac{1}{2}$ per cent. of the land tax. A complicated scale of allowances for small incomes is also part of the system. Incomes under 400 lire in classes B, C, D are exempt, and up to 800 lire the taxable sum is reduced. The declaration of the contributor is the basis of charge, but is tested by inquiry, and, as far as possible, the tax is collected by stoppage.

Notwithstanding the very elaborate provisions of the law, it is found impossible to reach a great deal of the national revenue. Incomes in classes B and C are very generally returned at much below their true amount. Like the property tax in the United States, the Italian income tax is ineffective through evasion. Thus, though the method of stoppage is only applied to a limited set of cases, its receipts are nearly as large as those from direct collection. Again, the proportion paid by companies is about 40 per cent. of the whole, a ratio quite inconsistent with all other available statistics. An analysis of the actual returns of revenue leads to the same conclusion. In 1874 639,302 persons made returns, and out of this number only 986, or 1 out of 640, admitted incomes of more than £1,000 *per annum*. Even though the wealth of Italy is much less than that of England or France, these figures cannot be accepted as a true representation; they simply prove the existence of fraud on a large scale.

One cause of such widespread evasion is the very high rate of taxation. Twenty per cent. is equivalent to 4*s.* 5*d.*

in the pound,[1] and so high an income tax would even in England lead to much dissimulation of income. The most obvious remedy is a diminution of the tax rate, combined with greater powers of assessment, more particularly in respect to professional and industrial incomes. The differentiation of the classes of income, which originated in an attempt to apply certain theories very popular at the time in England,[2] also tends to make the returns inaccurate and to embarrass the officials.

These drawbacks notwithstanding, Italian Finance has found a powerful resource in this form of taxation. The original £1,200,000 of 1865 had increased to £7,000,000 in 1875, to over £8,000,000 in 1885, to over £9,000,000 in 1890, to nearly £9,500,000 in 1894, and to £11,500,000 in 1899. It must besides be remembered that owners of land are excluded from the operation of the tax, since they come under the land tax discussed in a preceding chapter.[3]

The latest addition to the group of income taxes is that introduced into Spain by the law of March 1900. It is framed on the Italian type and comprises three categories (*a*) incomes from labour, (*b*) incomes from capital, (*c*) mixed incomes. In the first, the rates vary from 5 per cent. to 20 per cent., salaries under £60 being exempt. In the second group the variation is from 3 per cent. to 20 per cent., the last applying to certain classes of the public debt. The third class is charged at rates from 2 per cent. to 15 per cent. No additions for local finance are permitted. The estimated yield for 1902 is £4,200,000.[4]

§ 8. The German income taxes are best represented by those of Prussia and Saxony. The Prussian *Einkommen-*

[1] *I.e.* on a small part of permanent income; the other groups pay at the lower figures mentioned in the text.

[2] This view has received the support of Newmarch and J. S. Mill, as, too, of Leroy-Beaulieu and Chailley.

[3] For the Italian income tax see Chailley, 220–344; Alessio, i. 318–370.

[4] See the careful discussion by Piernas Hurtado, *Hacienaa Publica*, ii. 457–68.

steuer was introduced in 1851 as a development of the older class tax. It was only applicable to incomes over £150, and dealt with them by groups. A sum was fixed for each group amounting to 3 per cent. on the lowest incomes in that group: thus, *e.g.*, incomes between £600 and £720 paid £18, those between £12,000 and £15,000 paid £360, and all incomes over £36,000 paid £1,080, the highest sum due. Along with the reform of the class tax in 1873 the income tax was settled on a somewhat different scale, but with a general rate of about 3 per cent. The objections to this system as unequal have been so strong as to lead to the reform of 1891, by which the class tax [1] is absorbed in the income tax, and all incomes under £45 exempted. From that point the rate rises by degrees; between £525 and £1,475 it is 3 per cent.; on incomes over £5,000, 4 per cent. The idea of progression is thus realised, though in a very limited way. The method of assessment has also been changed. It was previously settled by official valuation, based on the materials possessed by the administration, but is henceforth to depend on the declaration of the taxpayer.[2]

It is evident that the Prussian income tax differs in some important respects from those in England and Italy The function of supplementing the other branches of receipts is entirely absent, as the rate is fixed, not movable from year to year. The produce taxes are not brought under the income tax, but are continued quite separately: the taxes on land and industry present, accordingly, apparent cases of double taxation. Finally, the productiveness is much less. In 1864 the amount received was over £500,000, in 1876 it was nearly £1,500,000, in 1884 over £1,750,000; for 1889-90 the estimate was over £2,000,000. Under the new system (with the class tax included) the

[1] See Bk. iv. ch. 3, § 2.

[2] For the Prussian income tax see Cohn, §§ 315–20, and for the recent reform, Wagner, *Finanz Archiv*, 551 sq.; also J. A. Hill, 'The Prussian Income Tax' in *Quarterly Journal of Economics*, vi. 207–26.

estimate for 1892–3 was £4,000,000, but the amount obtained was £6,240,000. It fell off slightly in the two following years, but has risen steadily since, and for 1901–2 exceeded £9,300,000.[1]

Saxony set the pattern to Germany of a classified and progressive income tax. Introduced in 1874, it was developed by the laws of 1878 and 1894, the last modification taking place in 1900. Incomes under £20 are free Those between £440 and £2,000 pay 3 per cent. Incomes of £4,000 pay 4 per cent. The yield of the tax in 1880 was over £600,000; in 1890 it rose to £1,030,000, in 1900 it amounted to £1,760,000. Austria adopted a so-called income tax in 1849 which was really a tax, partly on industry, partly on salaries. The ineffectiveness of this system led to the law of 1896, which introduced, besides the industry taxes already mentioned,[2] taxes on (*a*) interest, (*b*) personal revenue, (*c*) salaries of high officials. In 1900 these taxes brought in over £2,200,000, five-sixths of which was due to the taxes on personal incomes.[3]

To the foregoing may be added the taxes of the Swiss cantons. Their property taxes already mentioned are supplemented by income taxes, in many cases on a progressive scale. No two cantons have adopted exactly the same system in all details, but there are, as might be expected, general points of resemblance. The Zürich income tax follows the pattern of the property tax. The smaller incomes are taxed on a part only of their amount, and at each higher stage the excess over the preceding one is placed under greater pressure until the point of full liability is reached. Graubünden follows its property tax

[1] More exact figures are—

	Marks.
1892–3	124,842,848
1893–4	123,190,131
1894–5	122,029,765
1900–1	174,385,348
1901–2	186,888,684

[2] *Supra*, Bk. v. ch. 2, § 10.

[3] See Sieghart, 'The Reform of Direct Taxation in Austria,' *Economic Journal*, viii. 173–82, and the same writer's fuller account, *Finanz Archiv.* xiv. 1–110

by grouping incomes in classes, and by raising the percentage rate as they get higher. Switzerland is in fact the classical country of progressive income taxes, though the moderation of the rates, and still more of their application, weakens the conclusions that might otherwise be drawn.

§ 9. The income tax was first introduced into the United States during the trying period of the Civil War. At its commencement the rates were moderately progressive—3 per cent. or 5 per cent. according to amount of income, but were soon raised to the higher points of 5 per cent. and 10 per cent., until the close of hostilities allowed of a return to a uniform rate of 5 per cent. in 1867, and reduction to half that amount in 1871, with finally complete abandonment of the tax in 1873.[1] The highest yield was in 1866, in which year it brought in $73,000,000.

The severe depression in 1893 so affected the United States revenue as to cause a serious deficit for the year 1893–4.[2] This, coupled with the measure for tariff reform, led to the passage of an income tax fixed at 2 per cent. on incomes over £800 ($4,000), those below that level being exempt. Property acquired by gift or inheritance was to be treated as income. The Supreme Court by a majority of one declared the tax to be 'unconstitutional,' inasmuch as, being 'direct,' it was not apportioned in accordance with the provision of the Constitution. Though this decision, considering the meaning attached to the term 'direct' in the 18th century, is doubtful, it will prevent the employment of the income tax until a counter decision is given by the Supreme Court, or the unlikely expedient of a constitutional amendment is adopted.[3]

[1] The following are the precise grades—

	$	$	$
By Act of 1862	600 (exempt)	Between 600 & 10,000 (3%)	Over 10,000 (5%)
,, ,, 1864	,, ,,	,, ,, 5,000 (5%)	,, 5,000 (10%)
,, ,, 1866	1,000 ,,	... ...	,, 1,000 (5%)
,, ,, 1870	2,000 ,,	... ...	,, 2,000 (2½%)

[2] The amount was $69,800,000 (£14,000,000). See *infra*, Bk. v. ch. 4 § 6.

[3] See for this abortive income tax the admirable articles of Profs. Dunbar

Since the establishment of the third Republic several attempts have been made to introduce the income tax into France, but hitherto without success. One reason for this failure is found in the character of most of the proposals, which aim at a progressive system, and are consequently obnoxious to the conservative sentiment of the country. The system of personal declaration which progression necessitates, but which is regarded as inquisitorial, is another reason for the failure. Of late years, however, the feeling in favour of an income tax seems to be increasing, and successive finance ministers have sought to satisfy it. M. Doumer in 1886, M. Peytral in 1898, M. Caillaux in 1900 have each devised a measure, and in 1902 M. Rouvier seems about to follow their example. All such measures must provide for the abolition of the *Personelle mobilière* and the door and window taxes, but logic would seem to require in addition the inclusion of the *Impôt foncier* and also the *Patente*. Were the idea of progression definitely abandoned, it is not unlikely that the income tax would prove a good substitute for (or perhaps more truly a development of) the four direct taxes, to which the tax on movable values might be appended. Still the question is one of great difficulty and complexity.[1]

§ 10. We have deferred a discussion of some fundamental questions relating to the constitution of an income tax until the leading facts of its use were known. Most of them have been already encountered in connexion with the general principles of taxation, but they take a different

(*Quarterly Journal of Economics*, ix. 26-46) and Seligman, *Economic Journal*, iv. 639-67.

[1] Among opponents of the income tax are M. Guyot and Léon Say, chiefly on the ground of its progressive and 'personal' character. Guyot, *Impôt sur le Revenu;* L. Say, *Les Finances de la France*, ii. 163-78; iii. 255-87; iv. 576-99, 645-67. M. Chailley, in his elaborate *Impôt sur le Revenu*, is a strong supporter. Leroy-Beaulieu (i. 491) is neutral. Mr. Bodley explains that the income tax is always regarded as a device of radical politicians, and adds, 'My own observation leads me to believe that an income tax is unsuited to the French temperament, and that its imposition would be a mischievous error. *France*, 622.

shape when the income tax is treated as but one part of a larger system, and need to be handled specially with a view to that fact.

One important question is that of progression in the rate of charge. The general conclusion that we reached [1] as to the inexpediency of any progressive system has to be reconsidered when the income tax is used as a complementary resource. Progression in the case of such a tax may be necessary for true proportional taxation. If the smaller incomes are unduly weighted by taxes on consumption, their exemption, or milder treatment, under the income tax appears so far justified. A variation in the rate of charge is not open to the objection of arbitrariness, as it is determined by reference to the amount of other taxes. The other objections are not so readily refuted. Risk of evasion and unproductiveness may both be urged against the graduation of even a moderate complementary tax. Where the area is a large one, the effect on accumulation and investment will not be serious, as the distribution of taxation will, *ex hypothesi*, be equal, but the existing attempts at progression are, it may be said, hardly worth the trouble they involve. The English method of exemption and abatement has great advantages from the technical point of view, since it allows the sources of income to be taxed without reference to their amount.[2] The treatment of each person's income as a whole compels recourse to returns of a complicated kind, is disliked as being inquisitorial, and gives opportunities for escape to large masses of income. For these reasons the proportional rate is, on the whole, advisable.

The answer just given helps us in deciding as to the adoption of different rates on different kinds of income. The proposal that life incomes and those derived from

[1] Bk. iii. ch. 3, § 9.

[2] This is the really decisive argument against direct progression, as contrasted with the English method, which is 'degressive,' and which throws the task of claiming exemption or abatement on the person interested.

industry should be charged at a lower rate has received influential support, and is illustrated by Italian practice. When considering the distribution of taxation we noticed the general arguments as regards the income tax in England. It was for so long looked on as a temporary charge, that the idea of capitalising incomes subject to it gained a good deal of support. The defence of the strict proportional rate rested on two admitted facts: viz. (1) that no ingenuity could avoid some injustice, and (2) that any alterations would mean the destruction of the tax.[1] Its gradual passage into a permanent charge has greatly strengthened its position in this respect, though the cry to remedy supposed grievances in its distribution may gain greater support.[2]

The working of the Italian tax does not support the system of different rates. The lower scales for profits and salaries are confusing, and account for much of the loss through concealment of incomes. The single general rate would prove advantageous from a fiscal point of view, and with stricter assessment could be effectually carried out. The attempt to group incomes into 'permanent,' 'mixed,' and 'temporary' is, moreover, too rough to give satisfaction or to realise justice.

Allowance for necessary expenditure and repairs is one of the practical difficulties in the administration of the income tax. On principle, as the tax is one on income, not on gross produce, deduction of the expenses of production of the income taxed should be allowed. Where much fixed capital is employed, this is very hard to determine, and we can understand the preference of French administrators for the self-acting rules of the *Patente*. In respect to land the English system till

[1] 'The real tendency of all these exemptions,' said Mr. Gladstone, 'is the breaking up and destruction of the tax.' *Financial Statements*, 45.

[2] A new period of assault on the alleged inequalities of the income tax seems to be approaching. Mr. Blunden's proposal of a property tax (really a higher charge on permanent incomes) has much to commend it in the case of a high rate to meet exceptional outlay

recently failed to recognise the cost of repairs; it, therefore, treated this class of revenue with unusual harshness, and gave some support to the view that Schedule A should be regarded as a distinct land tax. The Finance Act, 1894, has partly remedied this grievance, as it provides for an allowance for expenses and repairs.[1] The exceptional treatment of farmers' profits is another fact pointing in the same direction; but it may be hoped that this anomaly will be gradually removed.

The exemption of savings has been already discussed, but one method—that of life insurance—appears to be a case of capitalisation; it is in fact turning a life income into a smaller permanent one, just as the purchase of an annuity is the opposite process. Up to a certain limit —one-sixth of the income—the English system allows exemption of insurance premiums, a privilege not extended to savings in general. Though the desirability of encouraging providence may be granted, it would seem that an exemption from duty on transfer after death would be a more fitting mode of bestowing the favour. It cannot be contended that an insurance premium is not a part of income and the principal created by its use will not contribute to the payer's income in the future. The case is, as Mill puts it,[2] one of concession to 'human feeling,' rather than a sound deduction from general principles.

The problem of assessment is another of the difficulties to be faced: between the Scylla of the contributor's evasion under self-declaration and the Charybdis of official inquisition it is hard to take an intermediate course; but the dealing with each separate part of income, the combination of declaration and official control, and above all the use wherever possible of taxation at the source of revenue, so characteristic of the English method, are undoubtedly the best safeguards against abuse. The direct contact of the citizen and the tax-collector is the most

[1] Limited to one-sixth for land and one-eighth for houses.
[2] Bk. v. ch. 2, § 4.

delicate part of the fiscal machine, needing care and use of the results of experience to prevent friction. Allowing for the inevitable margin of error, the results of the English income tax are eminently satisfactory.

§ 11. Any notice of the question of incidence may seem unnecessary in respect to a tax which falls on all the constituents of revenue. On whom can income receivers in general shift their burdens? Some of the suggested objects are certainly not available. Thus the vulgar idea alluded to by Mill, that the income tax falls on the poor by checking the expenditure of the rich, has no foundation in fact. Nor is there much force in the contention that in so far as the tax is paid out of capital it falls on the labourers,[1] as this is no peculiar quality of the income tax, but one common to all taxation. The State must obtain revenue, and unless the income tax were specially obstructive to saving, it would produce no peculiar effect. Looking at the subject in a rather different way we obtain a better result. The income tax is composed of taxes on rent, interests, profits, and the higher forms of wages; therefore it may be said that the incidence of these several parts of the tax will, taken together, give the incidence of the whole. This, however, brings us back in a large degree to its non-transferability; for taxes on rent, on the higher kinds of wages, or on employers' gains, are not easily shifted. Even in the case of interest, unless the growth of capital is checked, a tax tends to remain on the payer. Therefore, speaking broadly, we may say that the shifting of an income tax is not to be expected, and in the rare cases where it does happen is brought about, either by a check in the growth of capital through diminished interest, or by disturbances in the relations of the several industries and trades through its action. A progressive income tax will of course have a stronger tendency to cause the former effect. But though this reasoning is true in respect to an income tax imposed with scientific accuracy on the

[1] Fawcett, *Political Economy*, 538 sq.

various components of income it needs to be qualified in considering the actually existent taxes. Thus we should say that the mild treatment of farmers' profits in England tends to disturb the distribution of capital and affects rent. The incidence of an imperfect income tax can only be traced by analysing the tax into its elements, and examining the course of shifting in respect to each

CHAPTER V

TAXES ON CONSUMPTION: THEIR CLASSIFICATION: DIRECT CONSUMPTION TAXES

§ 1. The income tax as developed in the present century, marks the highest point attained in the methodising and skilful use of direct taxation. From the rude land, property, and poll taxes up to the existing system of charging the net receipt of the subject, regarded as a whole, or its several parts, there has been an unmistakable improvement in justice, productiveness, elasticity, and that absence of irritation which is so important from the political point of view. The natural order of advance has been in great measure the historical course of financial movement. If existing direct taxation is very far from being perfect, it is, at least, better now than it ever was before. The true aims to be reached are better understood, and there is a more intelligent effort made towards their realisation. In the present and immediately succeeding chapters we have to see how far another large department of taxation has received the benefits of like improvements. We have spoken of the taxes already discussed as being 'primary,'[1] since they include all possible parts of the sole normal source of taxation—income. In contrast to them, the great mass of charges imposed on consumption and enjoyment, on transfers and juristic acts is secondary, since in a thorough analysis its several

[1] Bk. iii. ch. 1, § 12.

elements may be decomposed into taxes on some form of income. But the realities of practical finance do not easily adapt themselves to this mode of treatment; whatever be the 'source' of taxation, its 'objects' are many, and the mode of imposition is too important a circumstance to be entirely neglected.

The same conclusion is attainable from another direction. The classification of taxes most in favour in Germany[1] places first those that fall on wealth in the making and next those imposed on its possession, and under either of these heads the various taxes already examined would be grouped. To these it, however, consistently adds an additional set of taxes levied on wealth in the using, and it is to the study of this form of taxation that we must now proceed. On both historical and financial grounds it is to the full as important as the taxation of income and property.

§ 2. The great body of taxes on consumption is capable of division on several different grounds. Thus the kind of commodity used may be employed as the basis of arrangement, giving the classes of (1) eatables, (2) drinks, and (3) other articles.[2] The subdivision of the second class into alcoholic and non-alcoholic drinks, and of the third into raw materials and manufactured articles, naturally follows. Another mode of arrangement divides taxes according as they fall on necessaries, conveniences, or superfluities, and is supported by reference to the important differences in the economic and social effects of these different kinds of charges. From a financial point of view, however, the best grouping is that according to the mode in which the tax is levied. It may (1) be obtained at once from the consumer, in which case it is, in one use of the term, direct. It may, on the other hand, (2) be charged within the country on the

[1] Wagner, ii. 233, 515; Cohn, § 332.

[2] This is probably the best plan in a purely descriptive or historical treatment. It has been adopted by Mr. Dowell (who gives tobacco a class to itself), and in great measure by De Parieu.

manufacturers or dealers, who are expected to shift the burden to the consumers. Or again, it may (3) be realised by a state monopoly of the industry or sale; while finally it may (4) be collected at the frontier. It is true that the same article may be differently treated in different countries,[1] but this circumstance does not affect the general principle. In fact, it is quite safe and convenient to follow the usual fiscal practice and deal separately with (1) the immediate taxation of enjoyments and commodities, (2) the excise or internal duties, including state monopolies under this head, and (3) the customs.

The order just given is also the best to adopt in a scientific inquiry, as the immediate taxation of consumption is the closest to the direct taxes on property and income, the border-line being in some cases indistinct. This absence of quite precise boundaries has been more than once noticed; the difficulty that it places in the way of rigid lines of demarcation is best escaped by placing the nearest groups in close connexion with each other. The real relations are in this way best perceived, and the grounds for the actual classification are better understood.

§ 3. Historically the system of direct taxes on consumers can be traced very far back. The levies of commodities in kind by the sovereign may, where they consist of articles used by the contributors, be regarded either as taxes on produce or on consumption, though the former is the more natural interpretation. In like manner the taxation of movable property may be regarded as a charge on its use. Thus the tax on consumers' capital in the shape of furniture, plate, and works of art is plainly the same in effect as a tax on their use. Taxes on direct consumption and use seem to have originated in the sentiment to which sumptuary laws are due—the desire to repress luxurious expenditure. The first measure of the legislator was to prohibit; when

[1] Tobacco, *e.g.*, is free in India, subject to excise in the United States and Germany, monopolised in France and Italy, and taxed by the customs in England.

that failed, the next was to tax the supposed injurious expenditure.[1]

There is thus a double origin for the existing taxes of this kind; they are stray remains, either of the older property taxes or of sumptuary enactments. With one doubtful exception their financial value is slight. No modern country derives any noteworthy revenue from their use. The reasons for this small return are to be found partly in the development of the excise, under which most commodities are taxed in the hands of the producer or trader. By adopting this method the State gains the double advantage of having to deal with a smaller number of persons, who can be watched with comparative ease, and of avoiding the annoyance that direct taxation causes. Direct taxes on consumption seem to combine the defects of the two classes of taxes as described in an earlier chapter.[2] They have the unpopularity and inelasticity of direct taxes, without the equality and definiteness that are the chief recommendations of the latter. Industrial progress has further curtailed their area. They are the readiest way of reaching commodities produced and consumed at home, but this once large group of articles has shrunk to a very narrow space. The factory system has been destructive to the method of direct taxation on the consumer. Where industry on the large scale prevails, the employment of an excise has very decided advantages; *e.g.* the concentration of breweries has made the license tax on home brewing insignificant. It may also be remarked that the system of indirect taxation through producers tends to promote production on a large scale. Heavy taxation on an industry is a grave danger to the smaller producers.[3]

There is, moreover, another reason for the decline of the direct consumption taxes. They have been in many cases

[1] Cp. Cato's over-valuation of articles of luxury after the repeal of the *Lex Oppia*, and his taxation of them.

[2] Bk. iii. ch. 4, §§ 8, 9.

[3] Leslie, *Financial Reform*, 241–2. This is one of the many instances in which economic forces act and react on each other.

imposed on luxuries, or, at least, on the consumption of a limited class. The power of changing the direction of expenditure is here at its greatest, so that even a moderate tax diminishes consumption very rapidly. This fact explains the small productiveness of the old assessed taxes in England, though a limited field of action is still left to this particular fiscal expedient.

§ 4. One important tax, which might be regarded as coming under the present head, has been considered at an earlier stage. This is the tax on dwelling houses when levied on the occupier. A very plausible case could be made out for this view. A house is as much a commodity as other more perishable articles, and it may fairly be classed among necessaries. A great part of the taxation so collected comes out of the occupiers' pockets, which lends further support to the conception of it as a consumption tax. It is, however, on the whole, more convenient to deal with it in immediate succession to the land tax, and in connexion with the taxation of buildings in general. The difficulties that arise respecting its incidence, and the undoubted fact of its falling back, under certain conditions, on ground rent, seem to justify that course. We may therefore limit any notice of it in this place to a reference to the earlier discussion.[1]

The other English taxes of the same character originated in the eighteenth century. Carriages, men-servants, dogs, and armorial ensigns were brought under taxation, and have continued in the same position up to the present. Plate, horses, watches, clocks, and hair powder have also, for a longer or shorter time been made contributory. The bare enumeration of these several items shows sufficiently the character of the taxation. It is imposed on certain kinds of expenditure, which, if not superfluous, are, at least, not necessary, and only possible where a considerable amount of wealth exists. The plate tax, so long as it continued, was a tax on one part of consumers' capital. The

[1] See Bk. iv. ch. 2, §§ 1–5 inclusive.

licenses for killing game, and the later one for guns, are strictly 'taxes on enjoyment,' and might indeed be placed under the taxes on 'acts,' but they find a more natural place in the present group.

The fiscal history of these taxes is instructive. At first separately levied by special commissioners, they were formed by Pitt into the 'assessed taxes,' and used by him as the basis of his 'triple assessment,' which was substantially a property tax. Its failure showed the defects of the system, and led to its replacement by the income tax. In the present century, after many alterations and extensions of exemption, the system of assessment has disappeared, and that of licenses been substituted, while the latest event in their history has been the transfer of their yield to local bodies in 1888. Points for criticism abound in respect to the English consumption licenses,[1] and the taxes that preceded them. In the first place they are unproductive,[2] as the subjoined figures for 1900–1 show. They are far better suited for the purposes of local taxation, and their transfer may be unreservedly approved of. But the further question arises as to their fitness for use in any part of the financial system. They have the great disadvantage of being very often unequal as between persons. It requires much watchfulness to prevent evasion in the case of sporting and gun licenses, and armorial ensigns, particularly the latter. The tax on male servants is so far a check to their employment, and special exemptions have to be made for occasional hirings. The carriage tax is rather complex and often presses unfairly on some classes. There is either the alternative of including all vehicles to the injury of trade and agriculture, or where, as at present, there are large

[1] To be distinguished from the trade licenses noticed in Bk. iv. ch. 2, § 8.

[2]

	£
Dog licenses	550,216
Carriage ,, ...	516,810
Game ,, ...	201,517
Gun ,, ...	115,942
Menservants	156,556

exemptions, the difficulty of administration is increased. A more comprehensive tax, such as the horse and wheel tax, proposed in 1888, would avoid much of this difficulty, and as a local resource would have the merit of making the users of roads contribute towards their maintenance, but its unpopularity and complicated incidence are both against it. The dog tax is perhaps, on the whole, the least objectionable, on account of its service as a measure of police, but for that very reason its rate, to be effective, should be so low as to deprive it of any great financial value.[1] The conclusion suggested on the whole is that which recognises the consumption licenses as a possible local contribution, but one entirely unfit for imperial taxation. It might be possible within limits to give the local authorities the privilege of selecting the particular articles to be taxed, and regulating their number and the rates of charge by the needs of the particular district.

§ 5. France has made a more sparing use of direct consumption taxes, and when employed they have had a sumptuary aim. Those established under the Directory were given up in 1807. Some, however, have been reintroduced: thus the horse and carriage tax was passed in 1862. A local dog tax was enacted in 1855, and the legislation as to game licenses dates from 1844. The tax on servants has not been restored. Among taxes that may be placed in the present category is that on societies, introduced in 1871—20 per cent. on the subscription of the members—which is practically direct.

The revenue derived from these imposts is small, being about £1,000,000,[2] though as, with the exception of the

[1] The Irish rate of *2s.* (with *6d.* additional for stamp) is for this reason better than the English one of *7s. 6d.*

[2] The respective contributions are—

Game licenses	£335,000
Dog tax	300,000
Tax on Societies	60,000
Horse and Carriage tax	190,000

The licenses on carriages should be added; they are placed with the 'drink' licenses in the financial returns.

horse and carriage tax, they serve as a measure of police, it may be expedient to retain them.

The development of direct taxation of consumption in other countries is less marked. Taxes on dogs, servants, and carriages, are a part of the optional communal resources in Italy, but their yield is unimportant. The dog tax, *e.g.*, was in 1883 only applied in about 1,400 *communes*, and produced less than £25,000.

Prussia tried these forms of taxation between 1810 and 1814, but abandoned them at the latter date. The tax systems of the Empire present some variety in the use of these taxes, so far as they have been continued. The dog tax is a communal receipt in Prussia; it is a state one in Bavaria and Würtemberg. The amount obtained from these direct taxes is inconsiderable.

In the United States the direct consumption taxes are assigned either to the States or smaller divisions, and they vary from State to State. The almost universal employment of the general property tax does in practice bring most of the objects of consumption taxes under charge. Some of the licenses so extensively used fall on enjoyment rather than on trade or production, but they are insignificant in their yield.

§ 6. From the foregoing notice of past and present taxation of this kind, we get a confirmation of the view already expressed that it is a decaying form of impost. No modern State has managed to raise a large revenue by its aid; on the contrary, its relative importance is much less than formerly. There is quite enough evidence available to prove that it can without inconvenience be surrendered to the local bodies, whose requirements make all new resources desirable, and who at the same time have not to meet sudden changes in expenditure. It may even be questioned whether the American or German State is not too large a division. The town or rural *commune*, or at highest the county department or circle (*Kreis*), is the

proper area for the application of the direct consumption taxes collected within it.

There is in fact a kind of resemblance between the poll taxes and those now under discussion. Both are employed rather freely in early communities, but decay as Society advances. The causes that reduce their services are different, though the result is the same. The poll tax is both unjust and unproductive, where wealth is unequally distributed; taxes on enjoyments and luxuries are too easily evaded to be of practical use in an advanced financial system.

CHAPTER VI

INTERNAL TAXES ON COMMODITIES

§ 1. DIRECT taxation of enjoyment or consumption is, as we have seen in the preceding chapter, of comparatively little financial significance. In this respect it presents a marked contrast to that system of indirect taxation that has now to be examined. All European countries rely on what is known in England as 'the Excise' for a substantial part of the revenue receipts.[1] Any failure in this branch of taxation would be a fiscal disaster very hard to retrieve. Even the United States, which in times of peace can dispense with internal taxation of most commodities, had, under the pressure of war, to apply this system in a particularly rigorous form.[2] Nothing but a much higher standard of morality in regard to the payment of direct taxes, or a very unlikely reduction of expenditure, will render the remission of taxes on commodities possible.

[1] Thus in England the receipt from the Excise on commodities has been for many years, speaking broadly, 30 per cent. of the total tax receipts—£26,050,000 out of £78,665,000 in the year 1894–5—but now hardly exceeds 25 per cent.—£31,600,000 out of £121,893,000 in 1901–2. The *contributions indirectes* and the fiscal monopolies in France show for 1901 a gross yield of £41,800,000. Allowing for the expenses of working the tobacco monopoly, the balance remaining is over 25 per cent. of the total tax revenue. The German Imperial excise is of less importance, but still gives a substantial contribution, estimated at £15,800,000 for 1900–1. In the United States the internal revenue for 1899–1900 was $233,000,000, that for 1900–1 $238,000,000 or over 40 per cent. of the receipts from every source.

[2] Bolles, *Financial History* (1861–1885), Bk. i. chs. 9, 10; Wells in *Cobden Club Essays* (2nd series), 479.

Another noteworthy feature of the taxes under consideration is their modernness in their present form. The English Excise is hardly 250 years old,[1] and the corresponding branch of revenue in other countries cannot claim much higher antiquity. A reference to general economic conditions supplies the explanation of their relatively recent origin. An extended and productive system of indirect taxation requires for its effective operation a large development of money transactions, with an accompanying separation of employments. Any attempt to tax producers or dealers in the expectation that they will recoup themselves by charging an increased price for their wares is obviously impracticable where most production is for domestic use, and such exchanges as do take place are transacted by means of barter. Besides, the natural tendency of financial policy is to begin with customs duties, partly as being easier to collect, but also as, in the popular belief, falling mainly on foreign producers. A further pre-requisite for the creation of an excise is the formation of an administrative organisation capable of effectively supervising the production of the dutiable articles within the territory of the State.

The tax system is, however, in all its divisions, the result of a gradual evolution, and therefore we need not be surprised at finding earlier forms of taxation falling on the production of commodities, and hence ultimately on consumers. The claim of the feudal over-lord to ill-defined prerogative rights is one source. Market fees and tolls were the foundation on which a system of indirect taxes could without difficulty be constructed, and the older import and export duties presented a convenient analogy. A charge on the sale of a domestic article did not seem a greater violation of the subject's liberty than if it were imposed on the introduction of a foreign one. The licenses on trades and occupations supplied another means for

[1] The first excise was created by the Long Parliament in 1643, Dowell, ii. 8 sq. ; Sinclair, *History of the Revenue*, i. 46, 278.

attaining the same end. When confined to particular industries they must evidently be regarded as part of the expenses of production, and—unless there is a differential gain—will be ultimately shifted to the consumers of the products.[1] A license graduated in proportion to the output or amount of sales is hardly distinguishable from a tax on the commodity produced. The relations of mediæval traders and craftsmen to their rulers and municipalities brought this kind of taxation into use as an expansion of the general property tax. Still more important was the influence of the quasi-private receipts of the Sovereign, which led to the monopolising of certain forms of production in order to increase the royal revenue. The state monopolies, of which so many examples are to be found in ancient and mediæval finance, are, however, so far as the price of the commodity is thereby raised, nothing but a special form of taxation. As already explained,[2] the normal profit on the capital employed is a part of the economic receipts, but any excess is unquestionably taxation.

In these different ways the indirect taxation of consumption has been attempted, and the last-mentioned—monopoly—is even yet employed as being, under certain conditions, a convenient mode of levying taxation.

§ 2. The problems presented to the financier in connexion with the whole system of indirect taxation are numerous and important. The earlier methods were directed simply to obtaining resources for the immediate wants of the State, without regard to the ulterior effects on the economic position of the nation. This irrational and almost instinctive procedure was soon replaced by attempts to use taxation as a means of guiding private expenditure in the supposed best direction. The desire to employ taxation as a moralising agency is even at present—as the duties on alcoholic drinks prove—an element of no incon-

[1] Subject of course to the complicated reactions discussed in Bk. iii. ch. 5, § 5.
[2] Bk. ii. ch. 3, §§ 6, 9.

siderable weight. The proper development of the taxes on commodities has, moreover, been hindered by mistaken views as to the true effect and operation of this part of the tax system. The earlier excises aimed at including all the various articles of consumption: it was thought that the maxim of equality demanded nothing less than this comprehensive procedure. The often described *alcavala* and *bolla* were imposed, the former on the sale, the latter on the manufacture of all kinds of goods. The excises of the seventeenth and eighteenth centuries were regarded by financiers as the principal form of taxation, destined, if not to replace all other kinds of imposts, at least to hold the principal position in the fiscal system. Dutch methods of taxation had shown how productive taxation on commodities could be made, and the greater the number of the taxed articles the more perfect was the system deemed to be. Popular sentiment by no means agreed with this idea of theorists and statesmen. The unpopularity of direct imposts has often been noticed as one of their defects, but no form of taxation has ever excited more genuine dislike than the 'general excise' which Walpole was unjustly accused of attempting to introduce into England. We have seen the weighty reasons that forbid the adoption of indirect taxation on a great number of articles,[1] and here we may add that the historical movement of the eighteenth century made such a course impossible as a permanent system of finance. The political revolution placed power in the hands of a class that would not tolerate it, while the less-noticed, but quite as important, industrial revolution established conditions under which it would not be endurable.[2]

[1] Bk. iii. ch. 4, § 5.

[2] The hostility of the Physiocrats to indirect taxation was shared, so far as internal taxation went, by the other sections of the liberal party. It is noteworthy that this disposition is also found in the labour parties of the present day, who resent taxation on commodities consumed by the working classes as taxation of labour. Cp. Lassalle, *Die indirecte Steuer und die Lage der Arbeitenden Classen.*

attaining the same end. When confined to particular industries they must evidently be regarded as part of the expenses of production, and—unless there is a differential gain—will be ultimately shifted to the consumers of the products.[1] A license graduated in proportion to the output or amount of sales is hardly distinguishable from a tax on the commodity produced. The relations of mediæval traders and craftsmen to their rulers and municipalities brought this kind of taxation into use as an expansion of the general property tax. Still more important was the influence of the quasi-private receipts of the Sovereign, which led to the monopolising of certain forms of production in order to increase the royal revenue. The state monopolies, of which so many examples are to be found in ancient and mediæval finance, are, however, so far as the price of the commodity is thereby raised, nothing but a special form of taxation. As already explained,[2] the normal profit on the capital employed is a part of the economic receipts, but any excess is unquestionably taxation.

In these different ways the indirect taxation of consumption has been attempted, and the last-mentioned—monopoly—is even yet employed as being, under certain conditions, a convenient mode of levying taxation.

§ 2. The problems presented to the financier in connexion with the whole system of indirect taxation are numerous and important. The earlier methods were directed simply to obtaining resources for the immediate wants of the State, without regard to the ulterior effects on the economic position of the nation. This irrational and almost instinctive procedure was soon replaced by attempts to use taxation as a means of guiding private expenditure in the supposed best direction. The desire to employ taxation as a moralising agency is even at present—as the duties on alcoholic drinks prove—an element of no incon-

[1] Subject of course to the complicated reactions discussed in Bk. iii. ch. 5, § 5.
[2] Bk. ii. ch. 3, §§ 6, 9.

siderable weight. The proper development of the taxes on commodities has, moreover, been hindered by mistaken views as to the true effect and operation of this part of the tax system. The earlier excises aimed at including all the various articles of consumption: it was thought that the maxim of equality demanded nothing less than this comprehensive procedure. The often described *alcavala* and *bolla* were imposed, the former on the sale, the latter on the manufacture of all kinds of goods. The excises of the seventeenth and eighteenth centuries were regarded by financiers as the principal form of taxation, destined, if not to replace all other kinds of imposts, at least to hold the principal position in the fiscal system. Dutch methods of taxation had shown how productive taxation on commodities could be made, and the greater the number of the taxed articles the more perfect was the system deemed to be. Popular sentiment by no means agreed with this idea of theorists and statesmen. The unpopularity of direct imposts has often been noticed as one of their defects, but no form of taxation has ever excited more genuine dislike than the 'general excise' which Walpole was unjustly accused of attempting to introduce into England. We have seen the weighty reasons that forbid the adoption of indirect taxation on a great number of articles,[1] and here we may add that the historical movement of the eighteenth century made such a course impossible as a permanent system of finance. The political revolution placed power in the hands of a class that would not tolerate it, while the less-noticed, but quite as important, industrial revolution established conditions under which it would not be endurable.[2]

[1] Bk. iii. ch. 4, § 5.

[2] The hostility of the Physiocrats to indirect taxation was shared, so far as internal taxation went, by the other sections of the liberal party. It is noteworthy that this disposition is also found in the labour parties of the present day, who resent taxation on commodities consumed by the working classes as taxation of labour. Cp. Lassalle, *Die indirecte Steuer und die Lage der Arbeitenden Classen.*

The influence of economic doctrines is also to be traced in the later legislation on the matter. Without at all asserting that modern taxation in this department is in full conformity with the prescriptions that result from economic principles, it may be said that there has been a decidedly beneficial remodelling of internal taxation, which has removed many of the objections that might be urged against its cruder forms, and there is every reason to hope that this progress will continue.

§ 3. The first problem to be faced in determining the character and extent of the taxation on commodities is the number of articles to be taxed. As we cannot with prudence bring all, or even the greater part, of the commodities produced under duty, it is necessary to make a selection, and to do so on certain definite principles. The old and simple rule of taxing whatever is most easily reached can hardly claim scientific justification. It is the product of fiscal necessity, not of providence and deliberation. One very important condition is the amount of revenue required; the expediency of taxing a given article will always, in some degree, depend on this condition. If, as we have found,[1] the whole category of indirect taxes is the outcome of the heavy expenditure of the modern State, it is plain that the greater the outlay the more imperious will be the calls of the Exchequer for receipts from this source. A great growth of expenditure means heavier taxation of commodities.[2] It is next necessary to settle the proportion that can be obtained by the various kinds of direct taxation, as well as by those further imposts that we have grouped under the title of taxes on acts and communications, before we can say what sum must be gained through the excise and customs. This, again, suggests a fresh consideration. From the

[1] Bk. iii. ch. 4, § 6.

[2] In preceding editions it was stated as an illustration that, 'With an increased expenditure of £20,000,000 per annum in Great Britain, the exemption of sugar from taxation could hardly be continued.' This has been confirmed by fact.

economic and fiscal point of view, the existence of import duties establishes the expediency of corresponding excise ones. Any other policy is detrimental to the revenue and therefore to be condemned. We may, however, escape the discussion of this question at present by regarding the protective import duties as being equivalent to bounties on production, and therefore forming a part of expenditure.[1] When the amount to be raised through internal taxation of commodities has been fixed, the more difficult question of distributing the total charge among the several dutiable articles, and of saying what these shall be, arises. One very plain limit is supplied by the condition of maximum productiveness in the case of each article. The rule of charging only what 'the commodity can bear' has not always been as carefully observed as it should be, but it is now well understood that increased rates may give diminished receipts. No single class of goods could yield the amount that modern fiscal systems require. But it is not merely the need of attaining the highest productiveness that leads to an extension of the list of dutiable goods; considerations of equity also come into play. The different classes of society do not expend their incomes in the same proportion on the many articles of consumption, and even persons in the same class have very different habits and tastes. A tax that presses heavily on one individual or class may scarcely affect another. Hence it is necessary to make a judicious selection of objects, in order to secure a fair distribution of the charge in accordance with the general rule adopted as a guide.[2]

[1] Cp. Bk. i. ch. 6, § 3; and for a notice of the fiscal aspect of protection, ch. 7, § 2 of the present book.

[2] The principle stated in the text is important, but is often overlooked. Thus in the controversy on the financial relations of Ireland to Great Britain it has been argued that the imposition of the same taxes must produce equality, the different character of consumption in the two countries being neglected. On the other hand, Sir R. Giffen (*Financial Relations Report*, ii. 161) has suggested that the possible existence of inequality is a ground for separate financial treatment, overlooking the fact that a system of taxation may be unequal as between individuals and classes within a single country in exactly the same

The inclusion or exclusion of necessaries will depend on the view taken as to the treatment of the minimum of subsistence. If its exemption be deemed proper, all taxation that would trench on it is to be peremptorily forbidden: where the duty of all to contribute to the service of the State is recognised, duties on such articles as corn and salt may be the easiest way of enforcing that responsibility. At the opposite extreme, the mode of dealing with articles consumed only by the rich will be affected by the amount already obtained through income and property taxes and duties on the transfer of wealth, as well as by the extent to which the idea of progressive taxation is accepted. Heavy imposts on luxurious expenditure tend to press more heavily on the rich, and are in principle the same as a progressive income tax,[1] though their actual operation may vary more according to circumstances.

The main brunt of indirect taxation will, in most modern communities, fall on the great intermediate class of goods that form the staples of consumption. It is one of the earliest observations in finance that taxation on the expenditure of the working classes will yield much better results than that which is placed on the apparently more profitable outlay of the comparatively few rich persons.[2] The objects of general expenditure must be brought under contribution, in order to secure the high return that is needed as a justification for the imposition of so vexatious a system as the excise.

Thus far we have reached rather limits within which the field of taxation has to be kept, than direct indications as to the suitable articles and the rates to be imposed. Another class of considerations will help us to make some further progress. An excise system must depend largely for its success on the technical conditions of the industries

way. From which it follows that the true remedy for injustice in either case is reform of taxation. Provided the tax objects are properly selected there is no injustice in placing two countries under a common system.

[1] Bk. iii. ch. 3, §7.

[2] *Wealth of Nations*, 375.

that it supervises. Where industrial improvement is rapid, the restrictions needed for the protection of the revenue are felt as a serious hindrance. The adoption of new processes, so necessary for the most effective production, is not readily carried out, and the system of taxation violates the maxim of 'economy' by inflicting loss on the community without corresponding gain to the State. The only escape is found in restricting the objects of taxation to a small number of articles, and in so choosing them as to include only those industries in which invention is not very active, or in which interference with it will not be seriously felt.

Again, it is evident that some commodities are far more closely connected with the work of production than others. A duty on manufactured silk would obviously have less effect on industry in general than one on iron. The former would—apart from its diffused effects—only concern the producers and consumers of silk goods; the latter would affect almost every industry of importance by enhancing the price of one of the most essential auxiliary materials of production. This contrast between auxiliary articles and those destined for direct consumption[1] leads to the rule that taxation of raw materials or goods that aid production should, as far as possible, be avoided. Not only are the real effects of duties on such articles harder to estimate; there is the further evil that the taxes have to be advanced by the producers for a longer period, and the ultimate increase of cost to the consumer is made greater by the interest on those advances. It is true that the State receives the money at an earlier time, but its gain is not sufficient to counterbalance the loss through interest on the locking up of what would otherwise be active capital.

The system of taxing commodities is consequently most

[1] For Economics this distinction has been worked out by Menger, who grades commodities in 'orders' according to their nearness to the consumer. Cp. Marshall, *Principles* (3rd ed.), 133-4.

effective when it is confined to a comparatively small number of goods, which form the typical objects of the general expenditure of the various classes and grades of the community, and which, at the same time, are not important elements in auxiliary capital. The production of these goods must, moreover, not be in a very scattered form, or in the hands of small producers, as excise supervision then becomes too burdensome to the industry and too costly to be effective. All the real aims of taxation on commodities can be accomplished without including many items in the list of dutiable goods. Productiveness, economy, and equity, are the ends in view; and they cannot all be secured without this limitation of the field of the tax collector; while equity, which seems to be violated, is really and substantially attained by a small, as well as by an extensive number of taxes. One article of general consumption is a better object for purposes both of revenue and justice, than thirty or forty minor commodities on which the cost of collection would be high and the ultimate incidence uncertain.

The last important influence that affects the selection of the objects of indirect taxation is the desire to discourage certain forms of outlay that are regarded as pernicious, or, to take the mildest view, not promotive of economic or other virtues. This idea, which lies at the root of all sumptuary taxes, is represented in modern finance by the treatment of intoxicating drinks and tobacco. In nearly every country these articles form the mainstay of the revenue from indirect taxation, owing to the two conditions of large consumption and heavy taxation. So far had this movement been carried in England, that it was quite within the limits of probability that both excise and customs would be confined to these commodities of doubtful advantage, as the former virtually was.[1] The recent pressure due to

[1] Some license duties and that on the railways' receipts from passengers are placed under the excise, but they really belong to another category of taxes (see ch. 8 of the present Book).

war expenditure has for the time checked this tendency, and, indeed, in the customs revenue reversed it.[1] Though the French *contributions indirectes* have a broader basis, they are yet largely dependent on the wine and spirit duties ; while the tobacco monopoly is highly productive. The internal revenue of both the United States and Russia is in a similar position, and the inferior yield in Germany is admittedly one of the weak points in the fiscal system of that empire.

§ 4. One result of the preceding inquiry as to the conditions that should be taken into account in framing a system of duties on commodities is to give strong support to the position that such duties must be varied according to the country in which they are applied. The really productive objects of taxation are not quite the same in any two countries. The tastes and habits of each community have to be carefully observed and taken into account, otherwise the revenue receipts will suffer. But the financier has not merely to study the direction of demand ; he must further pay attention to the agencies of supply. The system required for a wine-producing country, such as France or Italy, is not the same as that best fitted for districts in which alcohol is produced by an elaborate manufacturing process. Adjustment to the economic environment, so exceedingly desirable in the arrangement of taxation, necessitates the adoption of special taxes in different cases in order to gain the best results.

The same point is further enforced by the varying amount of revenue that is required, and the extraordinary differences in the amount of consumption on which taxation can be imposed. The exemption of necessaries from duty must be contingent on the power of obtaining the required amount from other objects. Thus salt, which is rightly free in England, has to be taxed in India owing to the absence of other resources, and sugar, which was released from taxation in Great Britain in 1874, has again

[1] See for the customs *infra*, Book iv. ch. 7, § 3.

known incident in this part of fiscal history—Walpole's excise scheme—was really a reform in the customs treatment of tea and tobacco, and excited prejudice rather by what it seemed to lead to, than by its actual provisions. The financial result of the many measures passed respecting the excise during the eighteenth century is best shown in the increased receipts. At the commencement of that period they had averaged £1,200,000;[1] by 1792 they had risen to £10,000,000. From the latter date the extraordinary drain of the Revolutionary war with France affected the financial policy of the country, and caused those fresh applications of taxation that have been so often described by historians. The existing rates were in nearly every case raised to the highest productive point (often as experience proved beyond it). The duty on salt was doubled, and later on again subjected to a 50 per cent. increase. Glass, tiles, and leather were also made liable to additional charges. Beer and ale, as might be expected, received specially severe treatment. At the commencement of the French war the various taxes on these articles or their constituents yielded £3,578,000; in 1815 they came to almost £9,600,000. The spirit duties were trebled during the course of the war, until in 1811 they stood at 10*s.* 2¾*d.* per gallon, or almost the present rate.[2]

Such very great increase of taxation, accompanied as it was by corresponding advances in respect to other classes of imposts, could not long survive the return of peace, aided by the application of proper fiscal methods. Unfortunately the abandonment of the income tax, and the injudicious methods of borrowing pursued by Pitt and his successors, made reform a work of some difficulty. The debt charge of £32,000,000, and the heavy military and naval expenditure, not readily brought back to a peace

[1] 'The revenue from inland duties had varied considerably in different years. In 1700 over a million, it was in 1702 nearly £1,400,000.' Dowell, ii. 62.

[2] For the details of these taxes, Dowell, ii. 208–245, and vol. iv. under the several heads.

footing, both hindered immediate remissions or exemptions. The national industries had, besides, become adjusted to this very heavy taxation, and caution was needed in the attempt to alter the situation. At first the want of revenue was so great that certain excise duties were increased, *e.g.* those on soap, malt, and British spirits. This extreme pressure did not, however, last long, and it became possible to carry out some moderate reforms. The salt duty was reduced, and its abolition fixed for an early date (1825). That on leather was lowered one-half, and the very high tax on British spirits (11*s.* 8½*d.* per gallon) was placed at 7*s.* in order to meet the illicit trade and in connexion with the lower duties on wine. The exertions of Huskisson were, however, chiefly directed towards the improvement of the customs, which, indeed, most urgently required reform. The internal taxes were not directly affected by the disturbing influence of the Protectionist system, and therefore the changes to be carried out were of a comparatively moderate character. They may be said to consist in (1) the elimination of raw materials from the list of goods liable to duty, (2) the contraction of that list to a very small number of articles, and (3) the placing of the weight of internal taxation on intoxicating drinks. A further aim has been to secure a complete harmony between the excise and customs systems, which has been reached by the abandonment of Protection, and the establishment of exactly equivalent duties in both departments. In fact, that substantial unification of the excise and customs, for which Walpole vainly risked his popularity has been definitely accomplished so far as financial effectiveness is concerned.

Some of the facts of this reform of the excise are not without interest. After the disappearance of the salt tax the duties on leather and candles did not long remain. In 1830–1 they were repealed. The impost on soap—that 'tax on cleanliness'—survived till Mr. Gladstone's first Budget in 1853. Glass was released in 1845, but paper

continued liable to duty till 1861. Starch and bottles were exempted in 1834, bricks and tiles in 1850. These repeals of duty, which seem so trifling, were really, taken together, a considerable boon to British industry, and to the bulk of consumers. The progress of the chemical industries may be dated from the repeal of the salt duty. Bricks, tiles, and glass are constituents of that most necessary commodity—a house, besides being of use in numberless other ways. The paper tax was even more than a 'tax on knowledge': it hindered the development of an important industry, and raised the price of an article capable of many different uses. These advantages were well worth the sacrifice of the revenue obtained from the abandoned duties.[1]

The treatment of alcoholic drinks stands apart from the general system pursued with respect to industries. In their case there has been no remission, except when there was a prospect of increasing productiveness. The only exception to this rule—the repeal of the beer duty in 1830, by which £3,100,000 of revenue was sacrificed—had in part the aim of making the malt tax more productive, and this was in good degree attained. Besides, the double system of taxing both malt and beer was recognised as inconvenient. During the half-century 1830–80 the malt tax was the mode in which beer and ale were taxed, and sup-

[1] The following were the amounts yielded by the excise taxes on the above-mentioned articles at the dates of abolition—

	£
Salt (1825)	380,000
Leather (1830)	360,000
Candles (1831)	476,500
Starch (1834)	90,000
Bottles (1834)	3,600
Glass (1845)	600,000
Bricks (1850)	456,000
Soap (1853)	1,126,000
Paper (1861)...	1,350,000
Total ...	4,842,100

plied a standing grievance to agriculturists. Its large yield —£8,000,000 in 1877—made it impossible to repeal it, but in 1880 the existing duty on beer was imposed in its place, partly to relieve the depressed farmers, but also in accordance with the principle that a tax should be as near the point of consumption as can be arranged, in order that the preliminary processes may be released from excise restraints. The returns from the beer duty for the twenty years 1881–1900 quite realised expectations. For 1899–1900 the amount was £11,887,000. An increase in duty (1*s.* per barrel) raised the yield to only £13,500,000 in 1900–1, indicating a decrease in consumption. The year 1901–2 gave £13,300,000, thus showing a slight decline.

The duty on hops, first imposed in 1710, became later on a subsidiary duty to the main tax on beer. It had the grave defects of being uncertain in its yield and pressing on the raw material, which was moreover an agricultural product. Accordingly this tax was repealed in 1862, leaving nothing of the kind, except the trifling duty on chicory, in the English excise. Its yield had varied from £86,000 in 1852 to £728,000 in 1855.

British spirits have presented greater difficulties. If the principle of fixing the duty in proportion to the amount of alcohol contained be adopted, the rate on spirits should much exceed that on beer, and the aim of encouraging temperance would lead to the same result. On the other hand, the principal seats of production of spirits are in Ireland and Scotland, and the average consumption in their case is also greater. Heavy taxation of the more alcoholic drinks therefore presses unfairly on those parts of the United Kingdom. Finally, the enforcement of the revenue laws in wild and mountainous districts was no easy matter, and consequently the limit of productivity was at first rather low. Existing methods are the outcome of the efforts to meet these several obstacles.

The scale of duty, previously fixed on different prin-

ciples in the three countries, was unified by Robinson (1825), the only difference being the higher rate in England (7*s.* per gallon). By a series of measures the Scotch and Irish duties were brought up to the level of the English one, itself raised by degrees, until in 1858 a uniform duty of 8*s.* per gallon was imposed. The increase in return was considerable. In 1829 the yield had been £4,800,000; by 1851 it was over £6,000,000. For 1859 the amount received was a little under £9,000,000. An increase to 10*s.* per gallon in 1860 made the tax still more productive, till in 1868 it was £10,500,000. The great prosperity of trade, and the more efficient excise administration, caused large annual increases, until in 1875–6 the highest return—£15,150,000—was obtained. From that date there was a decline for several years, but the yield again increased, and a new maximum was reached in 1891–2, when the receipts from this source were £15,693,000. After some fluctuation 1899–1900 gave another maximum yield with £19,335,000, followed by a slight fall in the succeeding year, and a heavier one in 1901–2 to £17,630,000.[1]

It is therefore apparent that the excise system of England, so far as it applies to commodities, is almost exclusively a tax on alcoholic drinks, and is carried out by supervision of the brewing and distilling industries, which involves a very complete control of their operations. The modern tendency to concentrate the production of both beers and spirits at a few centres makes this system less troublesome, and the heavy taxation in turn favours the larger producers. Further steps in this direction have been taken in the last few years by the extensive creation of limited companies, possessing a qualified monopoly of special forms of beer, ale, or whisky, and who therefore bear the first weight of increased taxation. The whole situation is a highly artificial one; by it the State draws very large resources from the taxation of what is an instru-

[1] An increase of 6*d.* per gallon imposed in 1894 was removed in 1895, but re-imposed in 1900.

ment of luxury, in many cases one of vice. The aim of reducing the national consumption of these drinks is naturally postponed to that of maintaining so material a support of the public revenue, and the problem of adjusting the duties between the different classes is very imperfectly dealt with. There may be some reason for favouring such beverages as are believed to possess some nutritive power and to be less likely to cause intoxication ; but the present scales of duty seem unfair as between the consumers of spirits and those of beer.

The trade licenses which accompany and are officially regarded as a part of the excise have been already discussed.[1]

From one point of view the internal tax system also deals with the important article of tobacco ; but until within the last few years it has been confined to the negative function of preventing its cultivation in the United Kingdom. This system of prohibition, which seems to be a direct violation of industrial liberty and an interference with a probably gainful employment, dates in England from the times of Charles II.,[2] and has been justified on the grounds of the inferiority of the home-grown plant and the great trouble of collecting a very high duty on an article of local production. At present licenses are granted for the purpose of experimental growing, though there is little probability of the cultivation extending.

The processes of the English taxation of commodities are reduced almost entirely to levies on the producers of the taxed articles, the sale licenses being rather charges on the profits of the occupations, which, however, does not prevent their being useful as adjuncts of the excise by bringing all producers and dealers under the notice of the authorities and facilitating supervision. Duties purely on sale are not employed, though the bonding system, by

[1] Bk. iv. ch. 2, § 8.

[2] The prohibition at first applied to Ireland, but was removed in 1779 in consequence of the American war. It was re-imposed in 1832.

which goods are retained under official control free of duty until withdrawn for use, nearly approximates to that form. Neither are duties on the land under cultivation for a crop of the taxed article in use. Finally, the method of monopoly is not a part of English policy. Spirits, beer, and tobacco would be the only objects for its operation, and each of them is treated in another way. In fact, the great characteristic of this form of British taxation is the simplicity alike of its objects and its processes.

§ 6. The French organisation is much more elaborate and possesses a longer history. Under the *Ancien Régime* indirect taxation had been extensively employed. The necessities of the State had led to the heavy and unequal salt tax, to the duties on drinks, on leather, iron, and other useful articles, to the monopoly of tobacco, and the costly and vexatious inter-provincial duties. The origin of the system may be traced to the fifteenth century, in which the monarchy was reconstructed after the English wars. A great expansion, however, took place in the seventeenth century, when the administration of Colbert had recast the financial system, and when such a new source of revenue as tobacco was secured.

The continuous development, apparently broken by the Revolution, soon returned to its old course, though purged of many of the defects that had previously existed. The vices of pre-revolutionary taxation arose rather from defective administration than from the inherent badness of the articles selected for duty. There were innumerable personal and local discriminations ; the *noblesse* were exempt from various charges, and some districts were free from duties that pressed heavily on others. Thus salt was under six different systems, according to the particular province, not to speak of the many local privileges. Similar complexities were connected with the duties on wines and brandies. But far greater was the evil of the mode of collection, which was by the system of farming or letting out to companies, who contracted to pay a certain sum in return for the col-

lection of the duties. This system, so characteristic of Roman Finance, recurs in the French indirect taxes, and did much to increase their unpopularity. The 'Farmers-General' were objects of universal dislike, and some of the members of the body paid the penalty during the Revolution.[1]

One of the first results of the disturbances that broke out in 1789 was a check to the collection of the indirect taxes. The offices for the duties on salt, on wines and spirits, and also the internal customs were attacked. Contraband salt and tobacco were freely sold, and the toll-barriers of the city were thrown down.[2] The failure to collect the *Taille* was more than paralleled by the case of the indirect taxes. The strong popular sentiment undoubtedly encouraged the Constituent Assembly, already imbued with the physiocratic dislike to taxes on consumption, to take the somewhat rash course of abandoning the greater part of the obnoxious duties.

After an ineffectual attempt to maintain it provisionally the salt tax was abolished in March 1790. In 1791 the *aides*, or drink duties, met the same fate, as did also the tobacco monopoly. The abolition of the *octrois* was decreed in February 1791.

So complete a break with past financial conditions could not continue,[3] and accordingly we find that the work of the next ten or fifteen years consisted in building up the structure on the same general lines, but without the serious faults that it had previously contained. The salt tax was restored in 1806, but the old inequalities and the system of

[1] Lavoisier, the eminent chemist, was one of the sufferers. For the system of the *Ancien Régime*, see Stourm, chs. 11–14. For the mechanism of the Finances, cp. Bk. vi. ch. 2, also Bouchard, *Système Financier de l'Ancienne Monarchie* and the *Dictionnaire de l'Economie Politique*, s. v. 'Finances de l'Ancien Régime.' For the earlier history, Clamageran, *Histoire de l'Impôt*, and for the latter part of the 18th century the elaborate works of Gomel, *Les Causes financières de la Révolution Française* (2 vols.); *Histoire Financière de l'Assemblée Constituante* (2 vols.), and *Histoire Financière de la Législative et de la Convention*, as yet only vol. i.

[2] Stourm, i. 295.

[3] Introd. ch. 2, § 4.

monopoly were not brought back. The suitability of tobacco as an object of heavy taxation made it advisable, after a series of ineffective attempts at taxation in the ordinary way, to re-establish the state monopoly of that article in 1810. The *octrois* were gradually re-introduced, beginning with that of Paris in 1798, and soon extending to other towns. Finally, the complete freedom of spirituous liquors from taxation was put an end to by the law of 1804, which imposed a tax on wine and cider when in the possession of the producer. Further taxation of this promising source speedily followed in the duties on the transport of drinks, and the tax on the amount sold by dealers. Thus in less than twenty years the system apparently overthrown at the Revolution was again in force, freed from its most objectionable features.[1]

§ 7. The existing French system, which in its main outlines was established at the fall of the first Empire, shows, when compared with that of England, a number of suggestive resemblances and equally suggestive differences. There is the same broad general treatment as respects the commodities selected for taxation and the proportionate burden placed on each class; there is also the same readiness to levy the duty at the most favourable point, and lastly there is the same prominence given to this kind of indirect taxation in the fiscal system. On the other hand the French system has a wider basis. Salt, so necessary both for domestic and industrial uses, is an object of charge. So is that very general article of consumption, sugar, whose treatment has so often harassed financiers, and which was for over a quarter of a century freed from duty in the United Kingdom. The paper tax has only been suppressed in the last fifteen years, while matches—whose taxation in England Mr. Lowe could not propose with-

[1] For the re-establishment of the French finances see Stourm, *Les Finances de l'Ancien Régime*. For Bonaparte's place see the same writer's lately issued *Les Finances du Consulat*. Mollien, *Mémoires d'un Ministre*, 1780–1815, is full of instructive details.

out losing whatever financial popularity he had possessed—are placed under a state monopoly, as is also gunpowder, while dynamite is taxed. Oil is another important commodity that has to suffer taxation, to which may be added candles. Acid and vinegar may close the list, which establishes that France possesses that diversity of indirect taxes which McCulloch believed to have been too hastily abandoned in England.[1]

Again, the procedure of the French administration is much more varied. Up to 1901 the drink duties were levied partly on wine in circulation, partly on the retailers who sold it, partly on its entry into towns, but this system only applied to the country districts and smaller towns. The two latter charges were, in 1875, in the case of towns over 10,000 inhabitants, combined in a single tariff (*taxe unique*). For Paris and Lyons a single duty—the *taxe de remplacement*—covered all three.[2] Beer and spirits are taxed at the point of manufacture, in fact on the system of the English excise. Salt and sugar are similarly dealt with, but in all these cases the duty on transport may come into operation.

A more remarkable feature is the use of monopoly as a fiscal agent. It is true that in England the Post Office is under this *régime*, but ordinary commodities are quite free from it. In France, besides the small monopolies of gunpowder and matches—the latter created in 1872, and conceded to a company, but taken up by the State in 1890—there is the great tobacco manufacture, which is altogether a state concern. Experience has shown that only by this means could sufficient revenue be obtained from it.[3]

These contrasts are to some extent due to the more rigorous administrative system of continental countries. Interference with internal trade would be much more diffi-

[1] *Taxation and Funding*, 231.

[2] By the Law of December 1900 the duty on circulation is the only one retained for wine and cider.

[3] See *Economic Journal*, i. 307–24, for a fuller account of monopoly for taxation.

cult, and cause more irritation in England. But the different position of the two countries is a far more powerful cause. It is comparatively easy to watch the manufacture of drinks in the United Kingdom owing to the concentration of the industry. The problem of supervising the vineyards of the French peasantry proved too difficult for the revenue officials of that country, and led to the repeal of the inventory duty of 1804. The insular position of Great Britain has been a further assistance in protecting her excise system from the introduction of contraband goods. Thus the price of the state manufactured tobacco in France has to be varied according to the proximity of the district to the frontier. The methods of each country are in fact adapted to meet the circumstances peculiar to its situation.

At the same time it must be said that in certain respects French taxation of home commodities falls short of the highest attainable standard. Some of the duties are of too small a yield to justify their retention. The salt tax, even though it is confined to that used for domestic consumption, is too irksome and unequal a charge to be maintained when its return for 1901 was only £1,360,000.[1] The taxes on oils, matches, candles, and explosives might also be removed. The sugar duty is a more doubtful case. Its yield is very considerable—£6,280,000 in 1901—and with the heavy burdens that the country has to meet such a resource should not be lightly abandoned.[2] Unfortunately the treatment of the duty on sugar has been complicated by the bounty system, which is evil alike for the treasury and the producers. Moreover, the technical problems connected with the measuring of the quantity and quality of sugar yielded are very difficult, as is also the question of substitutes. A uniform duty on the finished product, adjusted to equal the import duty on the article, is the best financial

[1] That is, including the customs duty on imported salt, the excise proper yielded £385,000.

[2] In the case of sugar also the customs and excise returns are combined, but the customs only brought in £820,000.

arrangement. The Brussels convention (1902) appears to give a satisfactory solution of the bounty question from the point of view of French financial interests.

The wine and spirit duties are an indispensable part of the system, and should be very cautiously treated. The exemption of wine consumed by the grower is a gap in the tax that at once reduces the receipts and makes its incidence unfair. Nothing but the hopelessness of levying the duty could excuse this omission. A system of licenses for private consumption, such as that adopted for private brewing in England, might in some degree remedy the grievance. A further cause of complaint has been found in the comparatively high duty on retail sales. The artisan who buys his wine in small quantities is more severely taxed than the large consumer, who has only the moderate duty on transport to pay. The impossibility of raising the latter tax without provoking an extensive contraband trade, and the loss that any lowering of the duty on retailers would cause, are the hindrances to reform. The duty levied on the entry of wine into towns with more than 4,000 inhabitants is a further pressure on the residents in them, though its consolidation with, or perhaps more accurately speaking replacement of, the duty on retailers, where the population exceeds 10,000, carried out in 1875, is on the whole a desirable measure. The attempt to exercise surveillance over the very large number of agricultural distillers has proved a failure, compelling resort to the tax on circulation of spirits. These difficulties—which are good examples of the inevitable dilemmas that indirect taxation gives rise to—are due in a great measure to the position of France as a wine-producing country. Taxation of the cheaper wines falls necessarily on the bulk of the population, as it is imposed on their usual consumption. The cry of a 'free breakfast table,' once so popular in England, would need for its realisation in France the removal of the wine duty. An important influence affecting the drink duties has been the desire to promote

temperance, shown in the various proposals to exempt or tax at a low rate, the less injurious beverages (*boissons hygiéniques*) and place heavy duties on spirits. These efforts bore fruit in the law of 1900, which placed a low circulation duty on wine and cider, with a similarly low duty on the circulation of beer. The duty on spirits was so adjusted as, it was hoped, to balance the loss on these reductions. The result of the first year's operation of the new system has been a very heavy falling off in the wine and cider duties (from over £7,000,000 in 1900 to less than £3,000,000 in 1901), a like fall in the beer tax (from £1,070,000 to £540,000), and a comparatively slight increase of £700,000 in the spirit duties (12,980,000 in 1901 as against £12,280,000 in 1900).[1]

Notwithstanding these grievances and gaps in the French system, it must be pronounced to be, on the whole, and considering the problems to be dealt with, a skilful application of well-devised administrative principles. Tried by the great test of productiveness, it answers the object for which it exists. The various indirect contributions bring in close on £26,000,000, of which the drink duties provide about £16,500,000, and the internal sugar duty £4,450,000. The monopolies gain over £18,000,000 (90 per cent. of which comes from tobacco). When the total is taken it comes to the large amount of £41,800,000. Of this great revenue, spirits, beers and wines, tobacco, and sugar are the principal sources, the other duties forming but a trifling supplement. As in England, these articles are the support of the Exchequer, while in France the drink duties further contributed £5,900,000 in 1900 to local finance.[2]

[1] More accurate figures are—

FRANCS (000's omitted).

Year.	*Wine and Cider.*	*Beer.*	*Spirits.*	*Total.*
1895	173,715	23,546	262,145	459,406
1900	177,621	26,778	307,032	511,431
1901	74,422	13,469	324,444	412,335

[2] See § 14, *infra.*

§ 8. Italian finance has not had the same opportunities for the development of a productive system of indirect taxation as those possessed by England and France. The poverty of the people and the short duration of the present kingdom have both prevented the creation of a complete system. Nevertheless, the eminent statesmen and economists to whom the conduct of affairs has been entrusted have made great progress in this direction, and have endeavoured to apply scientific principles so far as the difficulties of the situation would allow.

The tax system of Italy had to be built up on that of the several States out of which it was formed, and it had to supply sufficient funds to meet the growing expenses of the new government. These conditions made the adoption of taxes, in other respects very undesirable, a necessity. The grist tax, which fell on the main item of subsistence, was at once oppressive and unequal, but it became a source of revenue from 1869 to 1882, bringing in 83,500,000 lire (£3,340,000) in 1878, and an average of over £2,700,000 for each year of its continuance. Salt—another necessary—has been kept under a state monopoly, as it was in most of the smaller Italian States, and its estimated yield for 1901–2 was £3,000,000. Spirits, beers, and mineral waters have also been placed under an excise; so have cotton oil, chicory, gunpowder, and the more important article of sugar. A monopoly of tobacco has been conceded to a company, and the net return from this source is one of the largest items in the budget (over £8,000,000 in 1901–2).[1]

Italy, however, differs from both England and France in

[1] In 1897–8 the following were the receipts and expenses of the salt and tobacco monopolies—

LIRE (000's omitted).

	Gross receipts.	*Expenses.*	*Net receipts.*
Salt	72,846	11,499	61,347
Tobacco.....	188,120	40,251	147,869

making use of the town duties on goods as a source of state revenue. The Italian *octroi* duties are notorious for their severity, falling as they do on articles of necessary consumption, as well as on the common enjoyments. Flour, rice, meat, butter, sugar, wine, beer, and spirits are all subjected to these local customs for the benefit of the State, with additional charges for municipal purposes. The inconvenience of this method is indisputable: it causes local variations in taxation levied for common purposes, and it is, besides, open to the general objections to the *octroi* system. The tax on wine may be defended on the same ground as the (now repealed) French entry duty, viz. that it is the only possible way of reaching an article of such general production and consumption, but this very difficulty seems to point to some other form of taxation as the most desirable solution. The total yield of £2,000,000 from *octrois* for state purposes is not large enough to justify the employment of so unfair and unpopular a method of taxation.

In extenuation of these seemingly oppressive and burdensome taxes it is necessary to remember the smaller amount of the national wealth[1] and the impossibility of limiting taxes to such articles of superfluous, or at best convenient, expenditure as alone are dutiable in England. Where good objects of taxation are wanting, the financier must perforce adopt those that are indifferent or bad. The direct taxation of the country is also heavy, and therefore the question of fiscal reform is primarily one of expenditure. Curtailment in the military and naval outlay and in the cost of administration would allow at least the removal of the *octrois*, combined with a reform of the tax on movable wealth, that would be a great relief to trade and secure a fairer distribution of the total load. A judicious reform of the drink duties might even raise their productiveness without injury in other respects. The whole position of Italian

[1] The wealth of Italy has been estimated at £2,120,000,000, or one-fifth that of England. Pantaleoni, *Giornale degli Economisti*, Aug. 1890, 139 sq. Cp. Giffen, *Growth of Capital*, 153.

indirect taxation is a useful illustration of the modifications necessary in applying general principles to the economic system of a people at a somewhat low stage of industrial development. Such taxes as the grist tax or the existing salt monopoly would be unhesitatingly condemned on *a priori* grounds, but they were required in the particular situation.

The relation of indirect taxation to the consumption of the people is here shown afresh. It is not possible to gain large returns from a southern people through the duties on the stronger alcoholic liquors. Such taxation as that of England would check the use of spirits completely. The same statement would hold true of any particular article. The theoretical doctrine that the minimum of subsistence should be exempt from taxation, however well it may sound, can only be applied in a society that has a considerable disposable surplus. When dealing with such populations as those of Italy or India, taxation, in order to be effective, must fall on objects that constitute a part of necessary consumption.

§ 9. The system of excises had a comparatively early and wide application in Germany. Without entering closely into the details, it suffices to indicate the general fact. That the German cities should adopt a system of the kind was quite natural; it was merely an *octroi* applied by a virtually sovereign State, but it seems that the method was imitated by the various princes, and notably in Brandenburg, where 'the general excise' was introduced in 1640 for some towns and gradually extended. This tax, which was limited to the towns, affected corn, meat, drinks, raw materials, and imported goods. It was intended to fall on the country through the process of shifting, and was undoubtedly one of the principal sources of revenue. The reconstruction of the Prussian finances after the French wars resulted in the substitution of the 'meal and meat' tax (1820), which was imposed only on the towns, as a kind of compensation for the 'class tax,'[1] that affected the

[1] Cp. Bk. iv. ch. 3, § 2, for the 'class tax.'

country districts. The yield of these taxes, which were given up in 1873, was about £400,000.

Other taxes, more in accordance with modern practice, were added. Breweries and distilleries came under excise supervision, and a moderate tax on the production of wine was imposed. Beet-root sugar was placed under duty in 1840, the old salt monopoly was retained, and tobacco was made to contribute through a tax on the land given up to its cultivation.

The chief interest of this part of Prussian finance lies in the fact that it has furnished the basis for the system of the present German Empire. Its development had in turn been influenced by the need of adjusting internal taxation to suit the regulations of the *Zollverein*, as, *e.g.* in the cases of the sugar and tobacco duties. The advances in technical precision and productiveness since the formation of the Empire have not been as great as might have been expected. The salt monopoly was changed in 1867 into a tax on the article, which has been retained up to the present. The other subjects of taxation are, it must be said, treated in an unsatisfactory way. The sugar duty, which ought to be fairly productive, is affected by the bounty system, which in some years has absorbed the greater part of the receipts.[1] But this difficulty has been much reduced, and will

[1] 114,000,000 marks out of 141,000,000 marks in 1886-7. Cohn, § 413.

The following figures illustrate the relation of the sugar duty and bounties—

MARKS (000's omitted).

Year (Aug. 1)	*Excise valuations. Gross duty.*	*Bounties.*	*Net produce of duty.*
1886–7	142·4	108·8	33·6
1887–8	102·3	105·6	14·7
1888–9	111·2	80·1	31·1
1889–90	142·5	61·9	80·6
1890–1	154·2	78·4	75·8
1891–2	146·6	74·6	72·0
1892–3	86·7	34·5	52·2
1893–4	93·6	11·4	82·2
1894–5	100·7	15·0	85·7
1895–6	122·1	18·4	103·7

soon be removed by recent legislation, and now by international agreement. The yield of the tax may therefore be expected to increase with the increase of home consumption. The tobacco tax is suffering in a different way. At present it is levied through the inefficient excise system, and its amount is consequently low, £630,000 (12,600,000 marks) in 1899–1900. The remedy proposed in 1885 was the establishment of a monopoly, on the same system as that existing in France, Italy, and Austria, but it was defeated, and no further reform has been carried out. A like attempt which was made with regard to the refining of spirits met with the same fate. However, the rate of duty has been increased considerably, in the latter case with very beneficial results to the revenue, the receipts for the year 1899–1900 amounting to almost £7,730,000. Beer is also a source of revenue, but to a much smaller amount, owing to the lower rate, and the retention of separate duties by the state governments of Bavaria, Würtemberg, and Baden, which reduces the receipts of the Empire. The yield for 1899–1900 was £1,750,000.

German internal taxation is in some respects unfortunately placed. The separate interests of the different States hinder the most effective forms of duty being imposed, but still more the articles to be taxed are specially important products. Spirits, beer, and sugar are all exported, and engage a good deal of the national capital and labour. Taxation is, therefore, more keenly felt, and

MARKS (000's omitted)—*continued.*

Year (Aug. 1)	*Excise valuations. Gross duty.*	*Bounties.*	*Net produce of duty.*
1896–7	112·5	25·6	86·9
1897–8	137·6	36·7	100·9
1898–9	144·1	34·9	109·2
1899–1900	160·0	33·3	126·7

This table shows the effect of changes in the laws regulating the bounties, and the growth in recent years of the net receipts. The customs duty is so small that it may be neglected.

strict supervision by the revenue officials is more injurious. The treatment of agricultural distilling is a particularly difficult matter, and one that only admits of a compromise. Fiscal presumptions, whose operation we have already noticed,[1] are employed to escape the cost and trouble of more exact determination.

The economic and social conditions have, therefore, prevented as great a development of the modern excise system in Germany as has taken place in France: the duties are less productive—the total amount from this source for 1899-1900 was just over £18,000,000—and the deficiency is noticeable in those very articles that form the mainstay of British and French finance. Tobacco and alcoholic drinks do not pay what might be expected from them, while the sugar duty has been far under its real productiveness in consequence of the expenditure on bounties. The removal of this difficulty will be one addition to the receipts, and may be taken at £5,000,000, though production may fall off somewhat under the new regulations. An increased yield from tobacco, the end most needing to be accomplished at present, is to be reached—as a monopoly seems impracticable—by more effective excise supervision. Beer might also be made to provide a larger revenue than it does at present. But even if these reforms were accomplished, it is not to be expected that the revenue could equal that of more favourably situated countries. A large revenue from taxation of commodities implies either extreme rigour in the tax-system or a high standard of comfort in the bulk of the population. Revenue may be wrung out of the subsistence fund of the nation, or it may be obtained from its comforts and luxuries. Neither condition is found in Germany, and consequently the returns of the indirect taxes are comparatively small.[2]

§ 10. The tax-systems of other countries repeat with

[1] Bk. iv. ch. 2. § 7.

[2] For the German taxation of commodities up to 1888, see Cohn, §§ 411–23; for the later, and indeed the complete, history, Wagner, iv. 666–724.

modifications and new combinations the phenomena already described. The position in Austria-Hungary is somewhat exceptional as the two parts of the Empire form a single customs-area, but each section collects its own excises. Salt and tobacco are state monopolies in both countries, and the latter is an important contributory (for 1893 the net yield on tobacco in Austria was £5,600,000, in Hungary £3,000,000).[1] The spirit and wine duties are another productive item, Austria yielding slightly more than Hungary. Beer contributed £3,000,000 in 1900 to the Austrian excise, but barely one-fourth of that in Hungary. In respect to sugar also Austria is by far the larger contributor. Other taxes not usual in European countries are the cattle tax and the duty on mineral oil. The total yield of the combined consumption taxes (the salt and tobacco monopolies excluded) in 1899 was £16,390,000 (393,395,349 crowns) and of this Austria contributed less than £12,000,000 and Hungary less than £4,500,000. Vienna, Puda-Pesth, and Trieste pay octrois to the state revenue.

The chief commodities under taxation in Russia are sugar, tobacco and, most important of all, spirits. The first mentioned has been rapidly growing owing to the increase of home production. In 1890 the duty yielded 21,600,000 roubles, in 1898 it had risen to 47,700,000 roubles, in 1899 it was 67,300,000 roubles. Tobacco has also increased in yield, but in a smaller proportion, the duty for 1890 being 27,775,000 roubles, that for 1899 38,900,000 roubles. Both are, however, insignificant in comparison with the revenue from spirits, which amounted to 268,000,000 roubles in 1890, 298,000,000 roubles in 1898, and to 310,000,000 roubles in 1899.

This immense sum shows how the existence of a particular habit may affect the revenue of a country, and how it is possible under certain conditions to tax a very poor population. The contrast with the already noticed

[1] See Wickett, 'Studien über das Österreichische Fabrikmonopol,' *Finanz Archiv*, xiv. 198 284.

cases of Italy and Germany is very remarkable. Mineral oil is a minor contributory.

A further point of interest is the method employed in the collection of these taxes. Tobacco, as in the United States, is taxed by requiring stamped paper for its sale. Sugar is subjected to a strict supervision at the factories. The treatment of alcohol has varied. It was subjected to a monopoly which was farmed out until, in 1862, the excise system was introduced on financial grounds, and an increase of revenue obtained. The increase of intemperance amongst the peasantry has been the ostensible reason for a return to a monopoly strictly controlled by the State, which was inaugurated as an experiment in certain provinces in 1893, and next year was extended to the whole Empire, and has been accompanied by a further increase in return.

§ 11. Except in the crisis of war the internal taxation of the United States has always been very restricted. Hamilton's attempt to tax whisky (1791) had led to a rebellion, and the duty was given up, to be again tried during the war with England (1812–14), and abandoned at its close. From that time till the outbreak of the Civil War (1861) there were no duties on domestic goods, not even on spirits. The war requirements of the Federal Government compelled recourse to heavy taxation; in addition to the income tax and the customs, an extensive system of internal taxation was formed. 'Raw cotton was taxed at the rate of 2 cents per pound. . . . . Salt was taxed at the rate of 6 cents per 100 pounds tobacco from 15 to 35 cents per pound; cigars from 3 dollars to 40 dollars per 1,000; sugar from 2 to $3\frac{1}{2}$ cents per pound. Distilled spirits were first taxed in 1863 at the rate of 20 cents per gallon; the next year 60 cents; then 1 dollar 50 cents and subsequently 2 dollars.'[1] Most manufactured articles were also taxed, sometimes both in the raw material and the finished products, without any attention to the conditions of justice

[1] Wells in *Cobden Club Essays* (2nd Series), 479.

or productiveness. This very rigorous and on the whole effective application of taxation did not long survive the close of the war. By a series of enactments during the next five years all the duties, except those on tobacco and spirits, were repealed. The former, which is carried out by means of a stamp imposed on the tobacco as manufactured, varied between £5,000,000 and £9,000,000 during the twenty-five years ending in 1898. In 1897–8 its amount was £7,250,000.[1] The duty on spirits, which underwent several changes, being reduced to 50 cents in 1868, and raised to 70 cents, and then to 90 cents, and lastly in 1894 to $1·10 per gallon, was far more productive. The amount realised in 1897–8 was over £18,500,000.

In consequence of the war with Spain the duties on beer and tobacco were increased from July 1st, 1898. The beer duty was doubled, and by this means its yield was increased from $39,515,000 in 1897–8 to $75,669,000 in 1900–1. Tobacco likewise gave a return of $62,482,000 in 1900–1 against $36,230,000 in 1897–8. The speedy conclusion of the conflict has permitted the partial removal of the extra duties in 1901, and their complete repeal in 1902. The return from the spirit duties also has been higher ($116,000,000 in 1900–1). In its simplicity and absence of interference with industry the United States excise system closely resembles the English.

In the Indian system excise taxation is on a limited scale. The principal objects of duty are salt and spirits. The former article, which is, next to land, the most important contributory, is taxed in different ways, partly by the method of monopoly, partly by excise duties. Previous to 1879 the methods of taxation were complicated and oppressive, but that year Sir J. Strachey succeeded in reforming the system by introducing a uniform scale of duty. The proper balance between the different forms of production in India and the product imported from Cheshire is difficult to determine. The salt duty has yielded about 80,000,000

[1] For the tobacco tax, Olmsted in *Quarterly Journal of Economics*, v. 193 sq.

rupees annually for a long period. Spirits are taxed either at central distilleries or by farming out at auction. Opium and Indian hemp also come under taxation. The yield from spirits and drugs (which form the excise receipts proper) was estimated for 1899–1900 at £3,860,000 (or nearly 58,000,000 rupees). The excise duty of 3½ per cent. on cotton is attached to the customs.

§ 12. We are now in a better position for examining some general features of the taxation of goods. Certain points have been impressed by repetition. One is the great prominence of drink duties. England, France, Russia, and the United States regard them as the principal resource of the revenue. Improvements in the methods of German taxation will probably bring about the same result there. This circumstance suggests some important considerations. The moral difficulty of basing the financial prosperity of the State on the growing consumption of what is useless, and in many instances injurious, will be more and more felt in the future. The advocates of temperance can hardly remain contented with the present state of things in which the revenue from drink so far exceeds other receipts. But the possibility of sweeping restrictive legislation, extending perhaps to prohibition, raises the further question of the effect of such measures on the State's income. A reduction of fifty per cent. in the duties on spirits and beer would mean a great deficit in the English Budget, hardly to be replaced by any readily available substitutes. A much higher rate of income tax or the introduction of a property tax would probably have to be tried, perhaps combined with higher customs duties on tea and sugar. The difficulties surrounding any of these courses need not be dwelt on; the limits of productiveness are reached sooner in the case of other indirect taxes, while an extension of taxation on income or property would involve a shifting of its present distribution that would need the greatest caution before it could be justly applied.

Connected in certain respects with the drink duties is

the tobacco tax, which is so important a resource in France and Italy, and—as a branch of the customs—in England. This impost has the advantage of falling on a luxury and affording a means of taxing the poorer classes who cannot well be made to contribute directly, but it is also open, though in a less degree, to the danger of shrinkage through a change of habits, and is, besides, in common with the drink duties, hard to levy in countries where the production is extensively carried on, as a high rate inevitably leads to illicit traffic.

It is in great part owing to a recognition of these complications that the method of monopoly has been so much employed. To place the manufacture of an article in the hands of the State is a strong measure, to be justified only by very cogent reasons; but where the need of revenue is great, this sacrifice of a particular business to secure complete freedom for the others may be desirable. It cannot be disposed of by an appeal to the principle of non-interference as a rule peremptorily binding on the State. The real point to be aimed at is to secure the needed revenue with the smallest amount of restriction, a result sometimes best attained through monopoly. This, among other considerations, has led to the proposals for a state monopoly of alcohol, which have been brought forward both in Germany and France, but which have not proved acceptable in either country. The reasons advanced in favour of such a measure are weakened by the great extent of the industry and the elaborate appliances needed for its proper working. That a state department could with financial profit undertake the production or sale of spirits is not likely, though it was confidently believed that this result could have been reached in Germany.[1] A rigid excise system appears to be, on the whole, better both for

[1] The Swiss alcohol monopoly has given a small profit. The receipts from September 1887 to the end of 1900 amounted to £5,836,000, the expenses to £3,604,000, showing a surplus of £3,232,000 or about £244,000 per annum. The Russian experience since 1895 is also in favour of a monopoly.

the industry and the State. The progress of invention is certainly retarded by the routine that state management sets up, and therefore, where it is desirable to secure the continual development of new processes, production should be left to private initiative, and as far as possible released from surveillance. But whatever be the form adopted, intoxicating drinks and tobacco must in the immediate future be the principal resource—so far as indirect taxation is concerned.

Among the other dutiable articles sugar holds a high place, and if revenue be needed, it is one of the most eligible objects for taxation, much more so than a necessary commodity like salt.[1] The latter, again, is a preferable object to either corn or meat. A fiscal system that includes all these duties reaches a high degree of harshness, the addition of duties on raw materials being all that is necessary to make it attain the maximum in this respect.

The technical operations connected with the levying of duties deserve some notice. Modern appliances have made it far easier to gauge the exact product in most taxed industries; the strength of spirits or the sweetness of sugar can be ascertained with great precision by the use of special instruments, and in other cases similar aids are more or less available. As a means of checking fraud and stopping that 'leakage' and waste that has been so prevalent in the earlier attempts at taxation, they may be regarded as valuable contributions to finance. In another way the progress of invention has hampered the administration of both the excise and customs. For every product substitutes are now devised which cannot easily be brought under control. The application of a duty to a particular article involves the inclusion of perhaps forty or fifty different items with a carefully calculated scale of rates in order to avoid unfair preference or encouragement to evasion. This is, indeed, one great barrier to an extension

[1] See § 4, *supra*.

of the excise system. The best-devised duty from a purely economic point of view may fail in consequence of technical obstacles. In fact, the application of taxation is always dependent on a careful observance of these special circumstances. All the details of a duty are important in this connexion. Thus, the rate to be imposed must be regulated with reference to the intensity of the demand for the article, the gradations of the several qualities, and the effective power of testing that exists. The reasons for the repeal of the English paper and sugar duties were partly founded on the difficulties of discrimination: the adjustment of the American spirit duties, in order to meet the risks of illicit distilling and secure the highest return, has been shown by Mr. Wells to rest on similar grounds. The treatment of the several forms of spirits and beer in Germany has been largely conditioned by consideration of the effects produced by different methods of levying duties on the development of the industries and on the receipts of the State.

Nor is it merely the conditions that exist within the particular country that have to be considered. With the modern agencies of transport no community can be regarded as an isolated unit. Its method of taxing commodities will be influenced by the economic and fiscal systems of other countries. Due adjustment ought to be reached between excise and customs, and the trade relations with outside producers and consumers should be carefully studied. The greatest prospect of advance in financial arrangements probably lies in this direction.[1] To expect uniform taxation in all European countries would be Utopian, but there is room for approximation in the selection of the articles to be taxed, and in the rates of duty imposed. Thus, the treatment of alcohol and tobacco might possibly be made the same in a good many nations, and thereby the obstruction to industry and risk of contraband traffic in great measure avoided. Even at present

[1] The recent sugar convention is an indication pointing in this direction.

the monopoly system, as regards the latter article, is in force in France, Austria, Italy, Spain, and some smaller States, and may possibly be introduced into Germany. The rule of imposing higher duties on the more intoxicating spirits is now very generally adopted, though there is room for more complete agreement in both the mode of taxation and the rates fixed.

Finally, then, while it is evident that the forms and extent of internal taxes on commodities must depend on the financial necessities and the particular conditions of each country, it is also beyond doubt that what is vaguely called 'the progress of society' must lead to greater uniformity in both respects, though it would be premature to conjecture what will be the exact form of that common system.

§ 13. To complete our account of internal taxation it is necessary to notice its position in local finance. The United Kingdom and the American Union are very markedly distinguished from other countries by their freedom from indirect taxes for local purposes. There have been some cases of 'ingate' tolls in English and Irish towns, and the London wine and coal dues were a more important instance, but with these exceptions internal trade has been altogether relieved of duties. This freedom of commerce was according to Adam Smith one of the reasons for the greater prosperity of the country. The Constitution of the United States, enforced by the resolute action of the courts, secured internal free trade over the whole area of the Union[1] and prevented the establishment of any local barriers.

In continental countries a very different state of things has prevailed. Everywhere, in one form or another, duties have been levied on goods entering into cities. These taxes, which may be traced back to the dues (*portoria*) imposed by the cities under the Roman Empire, were adopted by the *communes* as a ready means of acquiring funds. So early

[1] Constitution of the United States, Art. i, § 10.

as the thirteenth century we find them in force in France, and their development continued till in the seventeenth century nearly every town possessed them. The ministers of Louis XIV. saw in this form of tax a valuable resource for the hard-pressed finances of the kingdom, and accordingly a part of the *octrois* was appropriated for the use of the State, a system that continued down to the Revolution. Other countries had the same system; the German towns levied duties on the commodities entering within their walls, and both the empire and the territory of Brandenburg derived revenue for their general purposes through the town taxes.[1]

The abolition of the *octrois* by the Constituent Assembly, and their reintroduction a few years later, have been already mentioned.[2] In other countries the same popular sentiments and the same pressure of actual facts have made their influence felt. No form of taxation is more oppressive on the artisan and small trading classes, and it has, besides, an indirect effect on the rural producers. On the other hand, where direct taxation is extensively employed by the general government, it is hard for local authorities to devise any less inconvenient form of duty that will supply an equal revenue. The opposed forces are seen in operation in the history of *octrois* in the present century. There has been a disposition to, as far as possible, get rid of these troublesome imposts, while at the same time they continue in several countries as a source of local, and even of general revenue.

§ 14. France in particular possesses a carefully arranged system. Municipal councils are empowered, and in certain cases compelled, to establish an *octroi*, which is distinctly recognised as a tax on consumption. The objects to be taxed may be food, drinks, fuel, fodder, and materials, but the power of taxing is limited by restrictions, which exclude articles already heavily taxed by the State or monopolised by it. *Octrois* on intoxicating drinks are

[1] *Supra*, § 9. [2] *Supra*, § 6.

specially regulated so as to bear a proportion to the general taxation of those objects.[1]

The system applies to 1,504 *communes*, or about one in twenty-four of the entire number; but as it includes all the large towns, its operation directly affects one-third of the population (13,434,000). The greater number of *communes* (864) raise the duties themselves. State officials manage 291, and 349 are farmed out at a rent. The city of Paris has a special *régime*, which extends to the outlying *communes*, and is administered by the *Préfet* of the Seine. A considerable revenue is obtained from this source. In 1900 it amounted to £14,200,000, one-half of which was raised in Paris. This amount is an increase over earlier years. From less than £2,500,000 in 1823 it has risen to £3,800,000 in 1853, to nearly £8,000,000 in 1872, and to almost £13,000,000 in 1895. This growth is due to the larger population of the towns and their improved condition.[2]

The Italian *octroi* duties in their present rigorous form only date from 1864; some of the smaller States had used them, but Sardinia and Tuscany were comparatively free.[3]

[1] Vignes, i, 205–16. A law of December 1887 allows the *communes* to remove, and compels them to lower their *octrois* on the *boissons hygiéniques* (wine, cider, beer, and mineral waters).

[2] The distribution of the duties among the different articles is shown by the following figures for the year 1900:—

	Francs.	*Percentage of total.*
Drinks and liquids... ...	155,524,100	43·8
Food	97,575,313	27·6
Fuel	46,600,138	13·1
Fodder	18,694,278	5·1
Materials	31,289,646	8·8
Miscellaneous	5,725,603	1·6
Total	355,408,980	100·0

Of the total on drinks 67,000,000 francs were levied on wine, 57,500,000 francs on spirits, and 16,500,000 francs on beer. The cost of collection in 1900 came to about £1,250,000, which should be deducted from the gross receipts of £14,200,000.

[3] Only six Tuscan communes had *octrois* out of 246, and only one in every ten of those in the kingdom of Sardinia. 'Report on the Octroi Duties in Italy,' Parliamentary Papers (C 6206), 1891.

Since the first measure on the subject several further orders and decrees have extended the system, until it has come to be productive of a large revenue as well as extremely oppressive. Without again considering that part of the duties which goes to the general revenue,[1] it appears that in addition to further charges on the articles already taxed by the State *octroi*, there are duties on a large number of goods arranged in the same categories as in France, with an extra division for colonial produce. The result is that, in contrast with the French duties, foreign goods already submitted to customs taxation are taxed over again on their entry within the 'closed' *communes*, and that both the cost of living and the distribution of industry are injuriously affected. The duties vary according to the population of the town, and are levied on sales in the 'open' or rural districts. The revenue received by the Italian *communes* from these taxes in 1897 was £6,300,000, which taken together with the part that goes to the central government, represents a much heavier burden than that imposed in France by the same class of duties. A complete separation between the tax systems of the general and local governments would seem desirable, and might be accomplished either by the exchange of the state *octrois* for local direct taxes, or better still by a complete reform of the methods of indirect taxation.[2]

The various German States have gradually reduced their indirect local taxation. Some German towns retain the *octrois* as a supplemental resource. In Bavaria this method is adopted, but the list of articles is not at all so extensive as either in France or Italy. North Germany is for the most part free from *octrois*, though a beer duty is levied, as *e.g.* in Berlin. In any case this form of taxation is of minor importance for the German cities. Austria and Hungary use the *octroi* system more extensively; some

[1] *Supra*, § 8.

[2] See, however, for a discussion of the modifications required, Conigliani, *Tributi Locali*, 232–62.

of the funds obtained in this way are taken for the central government, and the local taxes appear as additions to these state charges.[1]

More radical measures have been applied in some other countries. Belgium, as we saw,[2] abolished these taxes in 1860, and was followed by Holland in 1866, and by Spain in 1868, though the last-named country had soon to return to the old method. Denmark and Switzerland are practically without *octrois*, which are also of little importance in Portugal and Sweden.[3]

§ 15. When considering the general principles of indirect taxation, we concluded that its employment in local finance was objectionable, and certain to disappear under the influence of sounder ideas on the subject of taxation. The fact that so many countries can successfully manage their municipal administration without recourse to indirect taxes is of itself a strong point against their continuance. They have the unfortunate peculiarity of combining the defects of customs and excise duties; for they hinder trade between town and country and impose heavy pressure on urban industries and consumers. Thus the materials for house-building are taxed both in France and Italy; the ordinary articles of the labourer's consumption are compelled to pay toll before they reach him, and so are many of the materials on which he works. Inequality of distribution is another glaring defect in the *octroi* system, which varies in its incidence from place to place and between different classes. The one valid argument in its defence is the plea of necessity. To surrender £13,000,000 of the French communal revenue would be a hazardous step until an

[1] For the German *octrois*, see Cohn, §§ 457 sq. Cp. 'In Deutschland sind die Octrois von geringer Bedeutung, der Bieraufschlag in Bayern und einige neuere Verbrauchsabgaben Württembergs ausgenommen; Belangreicher sind sie schon in Oesterreich; Wien zieht aus den städtischen Verzerungssteuern eine ansehnliche Summe.' Schäffle, *Steuerpolitik*, 452.

[2] Bk. iii. ch. 6, § 7.

[3] Isolated *octrois* may be found in all these countries, *e.g.* that at Copenhagen.

assured equivalent was provided. This is the problem that reformers have to face, and the usual proposal has been the introduction of direct local taxes as a substitute. The difficulty of this plan lies in the resistance that most of the *communes* would offer to it. M. Léon Say's more fundamental method would alter the existing relations of the general and local governments, and place the direct taxes at the disposal of the latter, giving them at the same time increased functions.[1] Another and, perhaps, more feasible proceeding would be to follow the Belgian precedent, and pay over a part of the general indirect taxation to the *communes* in lieu of *octrois*. One important consideration indicated by M. Say is the distinction between the sixty towns having over 30,000 inhabitants, whose net revenue from this source is £10,400,000, and the remaining 1,444 *communes* that gain only £2,600,000. It is obvious that the latter class might easily replace their indirect taxes by additions to the *contributions directes*. Even the remaining towns—when Paris with its net receipt of £6,460,000 is deducted—ought to be able to furnish the £4,000,000 that would be needed by a development of the general taxation of spirits.

The case of Italy is a harder one ; though the burden of the duties is greater, so is also the need of revenue : and thus for the present it seems that reform, rather than abolition, is advisable. Exemption of the materials of industry, low rates on articles of necessary consumption, together with greater uniformity in the different tariffs, might be carried out with advantage to the revenue.

The first step in this direction has been taken by the law of January 1902, which provides for the gradual abolition of the *octrois* on cereals, and arranges for a subvention from the State for 70 or 80 per cent. of the revenue sacrificed. Further adjustments of local taxation, *e.g.* increased charges on real property, are specified, but this is evidently transitional and intended to lead to a more thorough reform.

[1] *Journal des Économistes*, December 1891, 449–461.

§ 16. The last question that has to be discussed is that of the incidence of taxes on consumption. Everyone is familiar with the proposition that they fall on the consumer, and are intended to be a deduction from his income when he comes to employ it. It, however, appeared that the process by which taxes are shifted is not so simple or uniform as this statement assumes.[1] That ultimately and 'in the long run' the bulk of the taxation of commodities falls on the general body of consumers is undoubtedly true, but this is in fact the case with a general income tax, which arrests the funds previously to their expenditure. But before we assert that a tax on a particular commodity comes out of the pockets of the consumers of that commodity, we must be satisfied of three things—viz. (1) that none of the burden remains on the producer who pays the tax immediately, (2) that none of it is thrown back on other producers or owners of land or capital who contribute to the production, and (3) that the consumer has no way of passing on the burden to another set of persons. But these conditions are not always to be found. In some cases the producer has a complete or qualified monopoly, or more accurately a differential advantage, and, when this is so, he bears the burden in whole or part. Again, the limitation of demand caused by taxation leads to a lower value of land, or fixed capital, or specialised labour suited for the industry, in which case some of the loss falls on the particular agent so affected. Finally, and this fact has been even exaggerated in the 'orthodox' theory of incidence, the additional cost of living may lead to a higher rate of wages, which must inevitably lower interest or employers' gain, unless indeed it is limited to certain groups of workers, when the consumers of their products may bear the burden.

Applying these general facts to existing tax-systems, it is an interesting question to consider how far the abolition of the present English excise would (*a*) increase the profits

[1] Bk. iii. ch. 5, § 5.

of brewers and distillers, as well as retail traders, (*b*) allow of higher prices for barley, hops, sugar, and other materials of the kind, or (*c*) cause a lowering of wages in consequence of the smaller outlay on drink by labourers and artisans. That each of these effects would in some degree be produced is, we believe, indisputable; but so much depends on conditions which cannot be even approximately estimated, that it would be impossible to offer a conjecture as to their relative strength. The effect on other industries through the sums set free from the purchase of drink, or the increased labour and capital required in the distilleries and breweries if the total expenditure on drink remained as before, would be a further puzzle. Now, if the remission of these duties would produce such effects, it is unquestionable that the development of the modern excise has caused, not perhaps quite the same, but quite as complex and important changes. When we take—as financiers and statisticians too readily do—the actual distribution of taxation as a guide to its real effects, we should never forget the far more intricate problems that the working of a set of taxes imposed on a complex economical system is certain to produce.

If this be true of the very simple and easily examined excise of England it holds good with still greater force of the more elaborate systems of France, Germany, and Italy. Where several articles are taxed the effects become intermixed; *e.g.* a duty on sugar tends to combine with duties on breweries where that article is used as a material. Especially where taxation is different in different cases we may expect complicated results; the duty on wines entering French towns is an element in the cost of living, and probably in the wages of the workmen residing in them, and hence on the price of the goods produced in such places, while this altered price may cause a redistribution of industry.

The *octrois* exhibit some of the best examples of the practical existence of these—at first sight far-fetched—

positions. One of the arguments of the defenders of local taxation of commodities is that their incidence is not really on the consumer, who would not benefit by their abolition. It is pointed out that in many cases the reduction or removal of the town barriers has not lowered prices. The gain is reaped by the producer or trader.[1] So far as this argument has any truth it illustrates the proposition that we have already laid down, though it is hardly a good defence of the system.[2] In like manner it has been argued that the Italian *octroi* system has compelled manufacturers to establish their industries in agricultural districts where the cost of subsistence is not artificially enhanced.[3] But what is apparent in the limited sphere of local taxation must be equally operative, though its influence is harder to trace, in the wider field of state economy.

[1] This argument will reappear in connexion with the incidence of import duties.

[2] This has been alleged of the Belgian reform and also of the partial remission of the Parisian *octrois* in 1848. The absence of any traceable effect on price by the abolition of the London coal dues is another instance.

[3] *Report on Octroi Duties* (C. 6206), 14, 15.

CHAPTER VII

CUSTOMS DUTIES

§ 1. THE taxation of goods at the frontier or on passing a fixed boundary line—what is known in England as the customs revenue—is far older than the system of internal duties. Almost from the origin of commerce we can find traces of its employment, and can note its gradual development into an important source of state income. Nor has it as yet lost much of its prominence. Notwithstanding the great increase of other branches of taxation, customs are still a conspicuous part of nearly every national budget, and in some countries are regarded as the only convenient mode of levying dues on consumption.[1]

The most primitive form of this kind of taxation is

[1] The following table shows the position of the Customs revenue in the leading European States—

		£ (000's *omitted*).	*Per cent. of total revenue.*
England	1901–2	30,993	25
France	1901	16,340	12
Germany	1900 (estimate)	25,250	47
Italy	1901–2 (estimate)	8,835	13
Russia	1900	21,750	23

A large part of the United States' revenue has generally been obtained from this source, often exceeding one-half of the total receipts. The lowest yield since 1884 was in 1893–4, when the Customs were only $131,818,000. The highest absolute amount was in 1900–1, when $238,585,000 were received, or 40 per cent. of the revenue from all sources.

probably that known as a transit duty, imposed on goods passing through a district. Modern African travellers have made us familiar with the 'gifts' demanded by each petty chief in return for leave to go through his country, an exaction which in the trader's case is practically a tax on the wares that he carries. How natural such a system is its revival in the earlier Middle Ages shows. In that disorderly condition of society each lord or *seigneur* asserted his right to charge dues on goods in passage, basing his claim on the services that he rendered by keeping the roads, bridges, and water-ways in fit condition, and by protecting the trader against violence. The collection of the tolls was, however, far more regular than the performance of the corresponding services, and therefore the first efforts of reviving commerce and increased royal power were directed towards the curtailment of such vexatious dues, which were either abolished or confined to payment for actual service done.[1] The use of transit duties was, however, continued in state taxation, and they have only been given up in the present century.

Next in historical order comes the export duty, levied on commodities as they leave the State's territory. The reasons for the employment of this kind of duty in early times can hardly be adequately appreciated, without considering the differences in economic beliefs and conditions. By taxing exports it was thought that the foreigner was made to pay a high price for native wares, or at worst that a more abundant supply was kept for the home consumer. Even if the burden should fall on the native producer, the article taxed was generally an important one, and its proprietors were bound to contribute to the public revenue. In fact the export duty is often a mitigation, introduced in the

[1] For the great number of tolls and passage duties in mediæval times see Clamageran, i. 160–1; Pigeonneau, *Histoire du Commerce de la France*, i. 96–99, 182–3. The tolls on the Seine in 1315 are set forth in a document given in Fagniez, *Documents de l'Industrie et du Commerce en France*, ii. 30–37; for Germany, Zimmern, *Hansa Towns*, 102

interests of the Exchequer, of the more rigorous prohibition of export.

The field of action for export taxes has been greatly diminished by the influence of the mercantile system,[1] which, looking on exportation as advantageous, was naturally hostile to anything calculated to restrict it. The few exceptions that it admitted for special reasons[2] have since been removed by the change in commercial policy, so that the use of export duties is now on a very limited scale.

The decline of the older forms of customs taxation has not affected the import duties, which indeed have come to be regarded as synonymous with the customs. The complete abolition of duties on exports would hardly affect the finances of European States, but anything that disturbed the revenue from imports would be the cause of grave concern to nearly all nations.[3] Though probably of somewhat later origin than transit or export dues, duties on imports were well established at an early period. They were employed under the Roman Empire, with separate customs lines or points for each province,[4] but the rates were moderate, not exceeding five per cent. *ad valorem*. The break-up of the Empire brought back the ruder state of things already described, and it was not until the royal authority became somewhat firmly established that duties on imports were effectively levied. The cities exercised the power of taxing goods, each in its local market and the adoption of this course had in many cases the same effect as the imposition of an import duty, but the great agency in the development was the expansion of the king's administration. England supplies the earliest example with its 'customary' dues on wine, accompanied by the heavy tax on exported wool.[5] Other European countries followed the same

[1] See *Introd.* ch. ii. § 5.

[2] For this side of Mercantilism, see *Wealth of Nations*, Bk. iv. ch. 8.

[3] India is, perhaps, the only country in which the revenue from exports exceeds that from imports.

[4] Mommsen, *Hist. of Rome*, iii. 397–8; Merivale, *Romans under the Empire*, v. 45; Clamageran, i. 73.

[5] Dowell, i, 75 sq.

course. France, *e.g.* adopted import taxation at a later date, export and transit dues being at first more prominent. As trade increased, and as the desire of encouraging national industry took a firmer hold, resort to import duties became more frequent. The rise of mercantilism, discernible in England from the time of the Tudors, and in France from the sixteenth century,[1] supplied a fresh force in favour of this form of taxation, while it tended to lower its financial importance in comparison with its use in assisting native producers against their foreign competitors.

Amongst the great services that Adam Smith performed for the cause of sound finance, his establishment of the true function of import duties was undoubtedly one. His vigorous attack on their employment as an instrument of economic policy helped materially to bring out their true use as a fiscal agency. To gain a large revenue and at the same time protect native industry from the entry of foreign goods was, he plainly showed, impossible.[2] The revenue duty is not protective, and the protective duty is not revenue-yielding. The influence of Adam Smith's teaching on administrators, and the need of revenue in consequence of increasing outlay, have led to at least a partial recognition of the financial aims of import taxation. Even in countries that adhere to a rigid system of protection, some of the duties are solely productive of revenue, and in all, the financial aim crosses and modifies the political one. A great deal of the modern protectionist revival is really due to the need of revenue to meet growing expenditure. The general adoption of a purely financial customs system with complete exclusion of all other aims, may be long deferred, but State requirements will always secure that

[1] For England, see Schanz, *Englische Handelspolitik*, and Cunningham, *Growth of English Industry and Commerce*, Bks. vi., vii; for France, Pigeonneau, *ut supra*.

[2] 'Taxes proposed with a view to prevent, or even to diminish, importation are evidently as destructive of the revenue of the customs as of the freedom of trade.' *Wealth of Nations*, 191.

the gaining of funds shall be one of the ends sought. The real danger lies rather in the probability of the methods employed being wasteful and unduly oppressive to the consumers.

§ 2. In order to understand the position of the customs in the fiscal system, it is essential to see that they are in reality a form or mode of collection, rather than a distinct branch of taxation. This point has been indicated before,[1] but it is worthy of repetition. Whether a given commodity—say salt—is taxed directly in the possession of the consumer, or indirectly, either by excise supervision over the producer, by making the production a state monopoly, or, finally, by levying a duty at the frontier, is in one respect immaterial, as any of these methods secures taxation of consumption. The separate treatment of the customs is only defensible on historical and technical grounds. This fundamental unity of the various forms of taxation on consumption at once leads to the conclusion that most of the conditions governing the excise may be applied without hesitation to the customs. Thus the whole formation of the tariff should be determined by the parallel system of internal taxation, and the rates of duty in both should be exactly the same. No one has disputed the justice of imposing a customs duty where an excise one is already in force. To allow, *e.g.* foreign spirits to enter duty free, while native ones paid heavily, would at once reduce the revenue and divert the normal course of industry. But exactly the same reasoning applies to the case of an import duty without an equivalent excise one. Expenditure is in this case also diverted, with the double evil of forcing some of the consumers to take what is in their opinion an inferior article and depriving the State of funds.

The problems of the excise as to the number of taxed articles and their selection reappear in connexion with the customs, though some modifying circumstances also occur.

[1] Bk. iv. ch. 5, § 2.

As regards the first, it is abundantly established that in order to secure productiveness only a small number of commodities should be taxed. This is best shown by the fact that in all countries the really productive articles are few in number. Before the restrictive system had been seriously altered in England (1839), five-sixths of the receipts came from nine articles. Forty years later (1880), three-fourths of the French customs revenue was raised on eight principal commodities; in 1900, more than half of it on four commodities: in 1887, corn, coffee, tobacco, and wine provided more than one-half of the German customs, and in 1899 corn, petroleum, and coffee performed the same service.[1] The lesson of the excise is repeated in respect to the customs. It is further clear that more than a single article will have to be taxed. To secure the maximum of revenue with the minimum of friction, it is expedient to get a sufficiently broad field on which to operate. By this means the stability of the revenue is best secured. A particular commodity may fluctuate in its yield from year to year, but the general customs revenue can be made to annually approximate to a certain amount for a long series of years.[2] The adoption of a pure revenue system greatly assists in the attainment of this desirable result.

The administration of the customs is relieved from one of the technical difficulties of the excise. Its treatment of all commodities is very much alike, and there is no interference with the work of production, or the development of industries; nevertheless other complications arise. The supervision of a long frontier is an arduous task, and where high duties are imposed, contraband trade can hardly be prevented. The more portable commodities are therefore

[1] *Report* of Import Committee (1840); Leroy-Beaulieu, i. 615; Cohn, § 407; Wagner, iv. 769.

[2] The English revenue from this source kept very near £20,000,000 per annum for forty years. In the period 1815–1900 it has only varied between £24,000,000 and £19,000,000, notwithstanding the extensive remission of taxation. The export duty on coal and the import one on sugar account for the great rise in 1901–2. The estimate for 1902–3 exceeds £35,000,000.

not fitted to bear heavy duties, and, in fact, the limitation of taxation to products of distant countries, and to fairly bulky articles, would, from this point of view, be advisable. It has been suggested as a rule of fiscal policy that customs duties should, as far as possible, be placed only on those goods that are not produced at home.[1] This, however, is hardly practicable, since, even where the exact commodity is not of native production, some available substitute is, and a tax that stimulates the use of substitutes is, in principle, as vicious as a protective duty. This problem arises in connexion with the English tea and coffee duties, but is not in their case of much practical weight.

The further questions as to the treatment of necessaries and raw materials must be answered in the same way as in the excise. Both are injurious, if they can be avoided, but the wants of the State may, as we saw,[2] compel the taxation of such articles as salt and corn, in which case the customs system must levy its part on the tax. Taxes on raw materials, though they impede industry and raise prices unduly, may, on the whole, be the least vexatious mode of reaching a particular class that would not otherwise contribute its share. A tax on raw cotton might, *e.g.* be the most effective and least irritating way of taxing the consumers of calico.[3] In fine, the customs system requires to be thoroughly adapted to the conditions of the general taxation on consumption, of which it forms a part, and has besides to conform to the technical limits imposed by its constitution and mode of working. Productiveness, equity, and economy both with regard to the cost of collection and the loss imposed on the community are the ends to be realised, and of these, the first and last are the most important, as unfairness in the pressure of taxes on commodities can be rectified by alleviations in other parts of the tax-system.[4]

[1] J. S. Mill, *Principles*, Bk. v. ch. 6, § 2. [2] Bk. iv. ch. 6, § 2.
[3] Cp. Mill's advocacy of a tax on raw silk. *Principles*, Bk. v. ch. 6, § 2.
[4] Cp. Bk. iii. ch. 3, § 10, for this use of a progressive tax on income.

§ 3. The English customs system is remarkable for its rigorous adherence to the principle of purely financial duties. All traces of a political aim in the imposition of customs charges have now disappeared.[1] This result has, however, been reached only as the result of a long development, during which other principles were operative. England, from its insular position and its stronger government, was more favourably situated than any continental State in respect to this form of tax. From being merely customary charges on wine and wool, the port duties expanded in the seventeenth century into a broader system. The receipts—derived from the general tax of five per cent. on all imports and exports, and the duties on wine, cloth, tobacco, silk, brandy—rose from £127,000, in 1604 to nearly £500,000, in 1641, and nearly £1,000,000, in 1688.[2] After the Revolution they fell off, owing to the French war and the increase of duties to ten per cent., but by 1702 they came to £1,500,000.

All through the eighteenth century, war and the influence of the mercantile doctrines hindered the growth of the customs revenue; profitable lines of trade were closed, and prohibitive duties encouraged smuggling. The most prominent features were the imposition of special duties and the increase of the general import duties. Wines, spirits, sugar, tea, and coffee had all to pay extra charges, while the ten per cent. general charge of 1698 became fifteen per cent. in 1704, twenty per cent. in 1747, and twenty-five per cent. in 1759. The pressure of the American War of Independence brought further additions in the shape of two separate five per cent. increases on the total duties existing on each article, with further extra duties on sugar and tobacco. Far greater, however, was the effect of the French wars (1793–1815), with the enormous outlay in

[1] The treatment of the wine duties and the export duty on coal indicate a retrograde tendency in this respect, still further shown in the re-imposition of a duty on imported corn.

[2] Dowell, i. 195; ii. 34. Some of the hottest contests between the king and the people turned on questions of taxation, *e.g.* the currant duty (Bates' case). For the earlier history, see Hall, *History of the Customs Revenue*.

which they involved the country. At six different times the import duties generally were raised, besides heavy special increases on particular commodities. The final result was that at the close of the conflict in 1815, the tariff contained nearly 1,400 items, and the rates were in many cases prohibitive.

In this unfortunate course of development but two periods of mitigation occur. Walpole's long peace administration (1722–39) secured the carrying of some desirable reforms; such as the abolition of the general export duty, the reduction of the more onerous duties on raw materials and the adoption of a new valuation of goods.[1] The opening of the younger Pitt's ministry also promised well. The duties on tea and coffee were lowered (1784); the Eden commercial treaty with France (1786) enabled an open trade to be carried on between the two countries, and in 1787 the customs laws were consolidated. These measures, however, had but a temporary effect; the need of securing revenue made recourse to bad taxes necessary, when the productiveness of the better ones was exhausted. But from the fiscal point of view it is plain that a simpler and better-regulated system would have been far more effective. In spite of the oppressive duties on almost every article, and the frequent increases of rates, the returns were not what might have been expected. In 1739 the yield was less than in 1702, and the growth up to the accession of George III. was slow.[2]

[1] For Walpole's fiscal policy see Morley, *Walpole*, 166–82; for his 'excise' scheme, Leser, *Ein Accise-Streit*.

[2] The following figures give the yield of the customs at selected periods:—

Year.	£
1702	1,500,000
1739	1,400,000
1760	1,824,000
1784	3,025,000
1802	8,815,000
1816	11,950,000

Sinclair, *History of the Revenue*, ii. Appendix No i.; Dowell, ii. 62, 109; Wilson, *National Budget*, 55.

In the period 1820–1860 this complicated and uneconomic tariff system was completely transformed. The old prohibitive duties were removed; so were all the surviving export taxes. Raw materials, articles of food, and, finally, manufactured goods disappeared from the customs list, until the attention of the customs staff was concentrated on a small number of productive articles, taxed at suitable rates. Thus the customs system became nearly as simple as the excise, though, owing to the conditions of production, it included somewhat more articles. Notwithstanding this notable diminution in the number of dutiable goods, the yield was fully maintained. We are not concerned here with the history of this important reform, carried out in more logical and consistent manner than is usual in English legislation.[1] Still less have we to consider the economic issues of the free trade contest;[2] but it is in place to note the real cause of the financial success achieved. It was by singling out the fiscal element in import duties, and neglecting other considerations, that the revenue was maintained so close to its former level. The great number of duties created or increased between the Revolution of 1688 and the Battle of Waterloo had two grave financial defects, for (1) they were not really

[1] There were three stages in the movement, viz. (1) the reforms of Huskisson 1823–7, which opened the way; (2) Peel's tariffs of 1842 and 1845, by which a substantial instalment of free trade was given; and (3) the measures of Mr. Gladstone in 1853 and 1860, which completed the work. For the fiscal history of this period, see Dowell, ii. 249–361; Buxton, *Finance and Politics*, i. 1–217; Bastable, *Commerce of Nations*, ch. 6; also Northcote, *Twenty Years of Financial Policy*. For the general character of the legislation, Wagner, iii. 300–1.

[2] It is important to maintain the distinction between 'finance' (*Finanzwissenschaft*) and 'economic policy' (*Wirthschaftpolitik*). To introduce a discussion of the merits of free trade or protection into a financial treatise would tend to confuse these separate subjects, and would thus be detrimental to both. Prof. Plehn's statement (*Finance*, 185 *n*) that in this work we 'refuse to discuss protective duties because we believe them [*sic*] "vicious" and "uneconomic,"' is, it need hardly be said, entirely destitute of foundation. Such a reason, as he rightly says, 'is not scientific.' Therefore to ascribe it without a shadow of evidence—the quotation marks inserted in his note are spurious—is a proceeding which may be left to the reader to characterise.

productive of revenue,[1] and (2) they violated the rule of 'economy' by taking far more out of the taxpayers' pockets than they provided for the State Treasury. The successive prunings of the customs tariff removed what had little life, and gave room for growth to the branches that remained. Cheaper raw materials made industry more effective; cheaper food left a larger surplus to be spent on enjoyments, and lower duties on the productive articles stimulated consumption, while they diminished smuggling. Consequently there was an apparently immense remission of duties without any real loss to the revenue.[2] It must however, be noticed that the low rates of duty—those on tobacco and spirits excepted—were accompanied by the development of direct taxation, and the stamp (including the succession) duties. The emergency of war or any weakness in financial management[3] was certain to lead to a return to higher customs duties and the extension of the list of 'objects' under charge.

Accordingly, in 1900 the tea duty was restored to the rate of 6*d.* per lb., at which it had stood previous to 1890, and the customs duties on spirits and beer were raised to correspond with the excise. In the next year sugar was taxed at 4*s.* 2*d.* per cwt., with a number of equivalent duties on substitutes, while the long disused export duty was revived in respect to coal, 1*s.* per ton being the rate. In 1902 the so-called registration duty on corn, which had been repealed in 1869, was reimposed. Thus the financial policy which prevailed since 1846 has within the last two years been decidedly modified by increasing the area of taxation.

The chief contributories to the customs revenue are now tobacco, tea, sugar, and spirits. The first mentioned article

[1] Thus in 1839 crystal beads yielded 1*s.* 7*d.*, starch 1*s.* 9*d.*, Bruges thread 1*s.* 3*d.*, extract of vitriol 12*s.* 3*d.*!

[2] Between 1815 and 1885 the amount of duties remitted was £35,861,000 against £8,063,000 imposed, or a balance of £27,800,000 remitted. Wagner, iii. 299. But there were no remissions in the last ten years of the period, and those in the preceding fifteen years (1861–75) amounting to £14,500,000, were on purely revenue duties—tea, sugar, &c. In the period 1885–1900 the tea, tobacco, and currant duties were reduced.

[3] As predicted in the 1st edition of this work, pp. 488–9.

paid £12,839,000 in 1900–1, but the return fell to £10,365,000 in 1901–2. Tea has been increasing in yield for several years; in 1899–1900 it gave £5,552,000, in 1900–1 with an additional duty of 2*d.* per lb. its yield was £6,275,000. The sugar duty for its first year (1901–2) produced £6,390,000. Imported spirits paid £5,133,000 in 1900–1. The other articles deserving notice are wine, coal, and corn. The wine duties have been falling off, their yield in 1901–2 was only £1,450,000, £38,000 less than in the preceding year. The export duty on coal during the year that it has been in force produced £1,314,000. The duty on corn is estimated to yield £2,350,000, and, if the expectation is realised, will rank fifth in order of productiveness. The present situation of the English customs tariff is of peculiar interest. Before the recent changes it seemed quite possible that the normal growth of revenue and the accompanying extension of direct taxation would have allowed of the removal of the tea duty, together with the smaller imposts on coffee, cocoa and dried fruits. The customs would thus have been limited as the excise is to taxation of intoxicating drinks and tobacco. At present the most prominent consideration is whether there will be a further extension of indirect taxation or a return to the simpler tariff of the end of the 19th century.[1]

As regards the particular objects of charge, the chief difference from the excise lies in the fact that certain exclusively foreign products are taxed. Tea, coffee, figs, raisins, currants, and wine are not British products, a position that fiscal regulations have also given to tobacco. Hence these commodities are contributories to the customs only. Beer and spirits come under both departments. An important development in fiscal expedients has led to what is practically a connexion between the two branches. The bonding or warehousing system, by which goods can be landed and stored free of duty, if they are placed under official control, is extensively used, and is now available in

[1] Import duties on timber and petroleum have been suggested by Sir R. Giffen as a substitute for part of the income tax (*Times*, January 10, 1902).

several inland towns, with the result that customs and excise become practically intermingled. Of the advantage of this concession it is needless to speak, but it is found rather difficult to extend it as far as traders desire, owing to the extra cost that it causes.[1] At all events, the sacrifice imposed on traders and on the community is minimised by this means, especially when the very small number of dutiable articles is taken into consideration.

§ 4. France, on the whole, shows a greater difference from England in customs (*douanes*) than in internal taxation. Not only are the dutiable articles much more numerous, but the aim of gaining revenue has never been the sole end in view. To reach the position of England, an entire recasting of the tariff would be necessary. All the points in which reform was carried out in the latter country remain for treatment. Food, raw materials, and manufactures are all subject to import duties, often high in amount. The development of this system can be traced from the sixteenth century, but its most striking period was under the administration of Colbert (1661–1683), when the old export and transit dues were diminished and the import ones, especially those on manufactures, increased. The whole customs system was, however, affected by the absence of unity, the internal duties between the different provinces being just as heavy, and far more injurious to trade. These obstacles were finally removed by the Revolution, and the reform tariff of 1791, which is the basis of the present structure, was established.[2] Unfortunately the liberal provisions of this measure were not continued in subsequent legislation. From the outbreak of war in 1792 to 1860, political rather than financial considerations governed the framing of tariffs in France.

The more liberal policy introduced by the Cobden Treaty

[1] On the bonding system, cp. Cliffe Leslie, *Financial Reform*, 199, 214–6.

[2] For Colbert, see Clamageran, ii. 599–697; also Sargent, *Economic Policy of Colbert*. For the internal customs, Stourm, i. 470 sq., and for the tariff of 1791, *ib.* ii. 61–75.

(1860) prevailed for some twenty years. Under it both revenue and protective duties were lowered and the total yield was less.[1] From £6,000,000 in 1859, the net customs revenue fell to £4,880,000 in 1869, but this, as Leroy-Beaulieu has shown, was due to the reduction in the duties on coffee and sugar. After the Franco-German war (1870-1) the need of revenue made the imposition of heavier taxation imperative. This coupled with the growth of protectionist sentiment led to the denunciation of the treaties of commerce and the re-establishment of corn duties in 1881 (increased in 1888 and 1891), and a general increase in duties. The customs revenue rose in 1872 to £6,000,000, in 1880 to £13,360,000, in 1885 to £15,440,000.[2] The effect of the latest adjustments in the tariff are exhibited in the yield for 1892, which exceeded £18,000,000. The highest point was attained in 1898, when the customs and salt duty almost reached £20,000,000. The returns for 1900 show a decline to the yield of 1892.

One result of this system is the comparatively small amount of revenue received. Contrasted with the English system, where for many years a revenue of £20,000,000 was obtained without any direct pressure on the necessaries of life, or the raw materials of industry, the highest yield of the French customs has not reached £20,000,000, though the list of dutiable articles is a long one. Nor does the French customs revenue possess the expansive power of the English one, as proved in the great increase of the last year (1901–2). The smaller return may be partially due to the lower standard of living in France, the difficulties of supervision, and the different position of taxed products, *e.g.* wine and tobacco are taxed solely by the customs in England. But the full explanation is to be found in the unproductive character of so many of the articles taxed. Thus, out of a total yield of £13,400,000 in 1887, but six articles produced more than £500,000 each, and they made up £9,800,000 or nearly three-fourths of the total. All the remaining goods produced only £3,600,000 or £400,000 less than

[1] Leroy-Beaulieu, i. 614.

[2] *I.e.* including the salt duty.

the single item of coffee. The same feature appears in 1900. Out of the total of £18,000,000 only three articles—coffee, petroleum, wine—contributed more than £1,000,000 each, and their yield came to £7,700,000, or over 42 per cent. Only six others yielded more than £500,000 each. Thus the duty on nine commodities came to £12,500,000, or almost 70 per cent.[1] Even of the productive duties many are seriously inconvenient, especially those on coal and timber. The corn duty, in addition to its protective operation, is very uncertain in yield, varying from £3,750,000 in 1894 to £668,000 in 1900. It is quite evident that the revenue is really supported from a small number of commodities, and primarily from coffee, which supplied £4,280,000 in 1893, and £5,050,000 in 1899. The duties do, it is true, bring in some revenue, and thus help to make the budget balance, but only at an excessive cost—a reform of the direct taxes and readjustment of the more productive duties would be the best course.

The absence of any due relation between the customs and the internal taxes is a further blot from the financial point of view. An import duty, uncompensated by an equal charge on the corresponding native product, causes a diversion of demand that is unprofitable both to the State and the consumers. Regarding such a method as—what it really is—a bounty on home production, we can see how an unnecessary cost is incurred through the system. More particularly is this true of the duties on raw materials, such as the various yarns, and on machinery and implements. Though such taxes have little direct financial significance

[1] The following figures are more precise :—

	£ (000's omitted).
Coffee	4,784
Petroleum	1,520
Wine	1,468
Sugar	972
Salt	966
Cocoa	732
Timber	716
Coal	700
Corn	668

they do much to dry up the source of all taxation by retarding the development of industry and the growth of commerce. While, then, the French customs system could hardly be as productive as the English with its duties on tea, tobacco, wine, and foreign spirits, it might yield a satisfactory contribution of at least £12,000,000, or probably more, by duties concentrated on a small number of commodities, and this revenue would further be steadily increasing, as the relief to industry from the other remissions came to operate.[1]

§ 5. The Italian customs system, with its comparatively brief history, shows the same faults and illustrates the same general principles as the French one. From less than £2,500,000 in 1865, the return rose to £11,000,000 in 1889–90, but this increase, which was due to the imposition of much higher rates of duty, pressing heavily on raw materials and necessaries, has not been maintained. In 1893–4 it sank to £8,800,000, the highest point since reached being £10,400,000 in 1895–6, and again in 1900–1. The really productive articles are few in number. In 1883 sugar, mineral oils, and coffee contributed more than half (53 per cent.) of the total, or £3,200,000 out of £6,000,000. One important contributory in later years has been the corn duty, which yielded £2,550,000 in 1895–6, and nearly £3,000,000 in 1900–1. Like the similar French duty, and for the same reason, it varies much from year to year, falling to under £1,100,000 in 1898–9. The customs revenue has been kept up to its present point only by very severe pressure on the consumers generally, which, it should be said, is in keeping with the general character of Italian taxation. Reform therefore is not so easy as it would be in France; the high duties bring in a much-needed revenue, and remissions of taxation are not likely to be compensated by rapid recovery through increased consumption.[2]

[1] On the French customs, see Leroy-Beaulieu, i. 612–31; Wagner, iii. 784-834, and *Erganzungsheft*, 124–34.

[2] On the history of the Italian customs, see the elaborate study by Alessio, ii. 346–452.

The German system is specially interesting as supplying one of the best possible examples of the gradual absorption of smaller customs areas in a common unity. The conditions of the German States, each with distinct custom-houses that were so many obstructions to trade, led the wiser financiers to promote the establishment of fiscal unions between the States. These efforts brought about the series of agreements by which the *Zollverein*, or customs union, including Prussia, Bavaria, Würtemberg, Saxony, Baden, and most of the smaller territories, was created, and which was the forerunner of political union. The immediate effect of the removal of internal restrictions was an increase in customs receipts, and a reduction of the proportionate cost of collection by one-half. The moderate rates of duty, derived from the Prussian tariff of 1818, assisted this expansion, which was hardly checked by some partial protectionist movements.

The customs union when transformed into the German empire at first continued its moderate financial system, and even (1873) made further reductions. But the need of revenue and the stronger protectionist sentiment brought about a much higher scale of duties in the tariff of 1879. That this important measure increased the receipts is indisputable; from £5,700,000 in 1878 they rose to £11,750,000 in 1885, to nearly £19,000,000 in 1890, to £20,750,000 in 1895, and reached £25,250,000 in 1900. Whether the mode adopted was the best one is not so clear. The corn duties, as in France and Italy, press on the working class, and, owing to the large home production, are decidedly uneconomic. The cattle duties have not even the advantage of yielding revenue. Still more objectionable are the taxes on wood, iron, and machinery in consequence of their effects on industry.

The limitation of the productive articles to a small number is, as we saw, also found in Germany. If corn, petroleum, and coffee were removed from the tariff, more than half of the revenue would disappear; and it is more

than probable that a reform of the duties on these articles, accompanied by an adjustment of the inland taxes on commodities, would allow of a great curtailment, if not an entire removal, of the remaining items.[1]

The tariff systems of Austria-Hungary, Russia, and the United States are even more remarkable for their subordination of financial to political objects. Under the influence of a protectionist policy the revenue duties on tea, coffee, and sugar have in the last-named country been either abolished or cut down to a very low amount, while the duties on raw materials and manufactures are many and high. There is no approach to equality between the internal taxation and the customs tariff; on the contrary, the duties are designedly fixed so as to give a preference to native producers.[2]

§ 6. The broad result of an examination of the customs systems of different countries is to indicate that financial operations are greatly hindered, and their effectiveness diminished, by the intrusion of politico-economic objects. We may indeed conveniently divide import duties into two classes: (1) the small number that contribute to the revenue in a satisfactory way, and (2) the far larger number that only provide income as it were incidentally. The protective duties of modern societies are in fact often rather a mode of expenditure than of revenue, since by the increased cost of collection that they make requisite, and by their indirect efforts on the financial duties, they take more from the Exchequer than they bring in to it. The line is not always clearly drawn; the same duty may be at once revenue and protective, as in the case of the French and German corn duties; but this situation really indicates either that the protection given is ineffectual, or that a great deal of the tax is wasted by the virtual bounty given to the home producers. Whatever view we may take of the

[1] For the founding of the Zollverein, see Roscher, § 102; also his *Geschichte*, ch. 34, and for the present German customs, Cohn, §§ 404–10; Wagner, iv. 655–66, 767–70.

[2] For the American tariffs see Taussig, *Tariff History of the United States*, where, however, financial considerations are not made prominent.

wisdom of a protective policy, we must allow that it means a certain outlay on the part of the State by the sacrifice of what would otherwise have gone to increase the revenue.

Another noticeable feature is the great prominence of import duties. Transit dues have been completely abandoned,[1] and export duties have a very subordinate place. They do not exist in France, Germany, or the United States, and until the adoption of the export duty on coal by Great Britain in 1901, might be said to have been confined to countries at a lower stage. Brazil has a productive duty on the export of coffee, as Chile has on nitrates, but India takes the foremost position with its opium and rice duties. The English coal duty, with its yield of £1,300,000, must come next in order. Some of the English colonies also levy duties on the export of their staple product, *e.g.* sugar in the case of the West Indian Islands.[2] But these exceptional cases only tend to confirm the rule that under modern conditions imports are the most effective objects of taxation. Nor is it hard to see the reasons that have made them preferred. The excise taxation of commodities almost necessarily carries with it the use of corresponding duties on imports, and some imported articles are very suitable objects for imposition. Hence their employment for revenue purposes. The desire to encourage native industry accounts for the duties on many articles that are very decidedly unfit to be taxed, and especially for the use of import duties with respect to them. We may indeed trace a general movement by which the transit duty has been abandoned, and the once prevailing export taxes reduced to insignificance, while the import tax comes to the front.

[1] The Indian transit duties—the most important of which was that on Cashmere wool (10 per cent.)—were abolished by Mr. James Wilson; see his *Financial Statement* (1860), 22. But part of the opium revenue is really a transit charge on the drug from the native States.

[2] The Indian opium duty—partly monopoly, partly transit—yielded 84,500,000 rupees in 1880–1, but the estimate for 1899–1900 was only 66,000,000 rupees, the Brazilian coffee duty gave £1,800,000 in 1889.

There is a further movement in respect to the customs system that is deserving of notice, viz. its extension over, or application to, wider areas. The case of Germany has been mentioned, but France in the last century, Italy in the present one, and even the United Kingdom are additional instances.[1] The latest example is the federation of the Australian Colonies into a single Commonwealth with a unified customs system in 1901. It is highly probable that further advances will be made in this respect. Proposals for customs unions of the British Empire, of Central Europe and of all the American nations, however they may differ in practicability, are all signs of the times, and show the direction in which movement will be made. To understand the real meaning of this tendency it is well to reassert a point previously noticed, viz. that financially considered, customs duties are but one form of the taxation of commodities, and that therefore the formation of a customs union is *pro tanto*, the substitution of excise for customs. How far this method can be carried at present is not easily determinable, but it may be suggested that ultimately the boundary duties on imports will share the fate of those on the export and transit trades. The taxation of goods at the frontier, in spite of the improvements in the mechanism of collection, is a serious obstruction to trade, especially under modern conditions in which rapidity and despatch are of such great importance. Just as the town *octrois* would be intolerable in England or America, so it may come to pass that a customs line between England and France will be too inconvenient to be endured. For the immediate future, however, the customs system must remain as a necessary element in the taxation of commodities that the heavy outlay of modern States makes indispensable.

§ 7. The problem of incidence—always a difficult one—is especially involved in the case of taxation of foreign

[1] The English customs system was extended to Scotland in 1707, but not to Ireland till 1825, when the Union duties were repealed. At present the Channel Islands are outside it, and the Isle of Man is under special regulations.

trade. The various parties affected and the very complicated conditions that govern the course of unimpeded trade, must be taken into account before a full interpretation can be given; it is, besides, hard to obtain confirmation or correction of the results of deductive reasoning by appeal to statistics, as they do not throw much light on the really obscure parts of the subject.

To begin with the most primitive form. Who pays the cost of a transit duty? According to Adam Smith 'duties of this kind are paid altogether by foreigners, and, perhaps, are the only duties that one State can impose on the subjects of another, without obstructing in any respect the industry or commerce of its own.'[1] The loss must, he supposes, fall on the sending or the receiving country. This view, however, needs qualification. A transit duty will force trade to take another direction, or if this is impossible will reduce its volume, and thereby injuriously affect the transport industry and the *entrepôt* business.[2] For example, a transit duty in Belgium would be disastrous to the railways of that country and to the position of Antwerp as an international warehouse. If we recognise that a transit duty is an import tax without a drawback on export, we see at once that it is unadvisable for the same reasons that have led to the universal adoption of drawbacks.

The export duty is, generally speaking, open to similar objections. As employed in mediæval times, it was designed partly to tax those foreigners who used the staple product of the country, and partly as an impost on the producers, or owners of natural agents. It is evident that the incidence of the tax will vary according to the position of the article taxed. That the home traders will try to raise the price is certain, but their success in this endeavour will depend on (1) the extent to which outside competition

[1] *Wealth of Nations*, 379.

[2] The abolition of the Indian transit dues was for the object of stimulating through trade. Wilson, *ut sup.* 22.

is possible, and (2) the need that foreigners have for the article. Where several sources of supply exist, the effect of taxing one of them will be to turn demand to the others, and where increased price checks demand, it tends to bring about a fall. Thus it may be said that, in most cases, an export duty is chiefly paid by the country that imposes it. Unless the country has a complete monopoly of the product, and the foreign demand remains unaffected by a rise of price, the whole burden cannot be transferred to the consumers. This case is, it need not be said, rarely found,[1] but any approximation to it will partly pass the tax to the foreign consumers. Still as a practical result, the bulk of the duty falls immediately on the producers of the taxed product, though it may be shifted by them to the owners of land, skilled labour, or fixed capital concerned in the business. A large number of export duties might even by diminishing foreign trade lower the rates of wages and interest generally.

The effects of an import duty have to be judged on the same principles. The usual incidence will be on the consumers of the commodity, but where no other market is open to the foreign producer, and where any increase of price arrests demand, the burden of the tax will be transferred to the producing country, with of course the same ulterior effects as those found in respect to export duties. It is also true that such a case is hardly in existence. The foreign producer has other markets, and demand is not often so sensitive; besides there is always the possibility of transferring labour and capital to other employments, should the pressure be sufficiently severe.[2]

[1] Wool in mediæval England and opium in India at present have been suggested as examples, but the latter is undoubtedly open to some competition. The newly imposed coal duty has given rise to much discussion on this point. Mine owners, lessees, colliers, shippers, foreign consumers, and the home consumers of imported commodities have each and all been put forward as the real bearers of the tax. Cp. Jevons, *Coal Question*, 337.

[2] For further discussion of this complicated question, see Nicholson,

The preceding considerations suggest that it is possible, in some instances, to place the weight of taxation on foreigners, and thus to levy what is substantially a tribute from them; but they also show that the probability of success in any design of the kind is very slight. It is further to be noticed that it is through revenue duties only that any advantage of the kind can be gained; a protective duty, if effective, brings in little or no revenue. That such duties are injurious to foreign countries is, we believe, unquestionable, but they are as certainly not advantageous to the revenue of the nation that imposes them. The corn duties of France and Germany may perhaps somewhat reduce the demand for Russian and American corn, and thus lower the price obtained by those countries, just as the English tea duty may have in part been paid by the Chinese; but in the former instance a corresponding excise duty on corn, if practicable, would add far more to the revenue with, on the whole, less sacrifice.[1]

A study of the question of incidence in relation to customs duties, therefore, leads to the conclusion, that while their real operation is often complicated and difficult to follow, the main burden falls on the country that imposes them, and that it can hardly ever hope, even if it should so desire, to shift any substantial part of its taxation to another nation or nations. On the whole the duties on imports must be regarded in common with the excise, and, where it exists, state monopoly, as one part of the system for taxing the consumption of wealth.

Principles, iii. 342–9; Seligman, *Incidence*, 300–304; Edgeworth, *Economic Journal*, iv. 39–48; Bastable, *International Trade*, 110–24, and *Britt. Assoc. Report*, 1889, 440–48, also cp. Bk. iii. ch. 5.

[1] For the corn duties, Wagner, ii. 359, 367; Conrad, art. 'Landwirthschaft' in Schönberg, ii. 247–260; for tea, Senior, *Pol. Ec.* 184.

CHAPTER VIII

TAXES ON COMMUNICATIONS AND ACTS

§ 1. When considering the system of taxation, we recognised that, in addition to the primary taxes levied on the income of the contributors and those secondary imposts affecting the consumption of commodities, there remained a large group of charges not to be placed under either category. Communications, transfers of property, inheritances and legal transactions have all been made to supply a part of the State's revenue.[1] The principles on which this part of the tax-system should be based, and the justification for its employment, have also been briefly noticed; but there can be no doubt that very different elements have assisted in its establishment. There is, first, the close resemblance of some of the objects taxed to commodities. A charge on transport is very like a duty on goods transported, and the same close connexion exists in such cases as the advertisement and newspaper taxes: they might be called 'taxes on quasi-commodities.' Another contributing agency is the 'fee' system. Some of the taxes on acts are but extensions of fees paid for services rendered. Land transfers and other judicial acts require the intervention of state officials, for whose services a charge may fairly be made, and these payments are easily developed into taxes. In like manner, the economic receipts from public industry or possessions may, through the use of monopoly, be carried to a point at which they become in part taxation. Older

[1] See Bk. iii. ch. 1, §§ 11, 12; ch. 4, § 10.

perhaps than any of the foregoing is the effect of the sovereign's prerogative rights. The general power over the subject's property, whether expressed in the feudal forms, or in the older idea of *dominium eminens*, issued in duties on the transmission of possessions from the dead to the living, as well as in the case of transfers *inter vivos*. The fact that all these elements have contributed towards the creation of the taxes under consideration, and supply the historical interpretation of their existence, does not in the least affect the positions that at present the true legal ground of such charges is to be found in the legislative power of the State, and that their financial justification depends on the place they hold in the tax-system. A valid defence can be only based on their being conducive to the ends of economy, equity, and productiveness; and it was in that light that we admitted their legitimacy under present conditions.

§ 2. The first of the sub-classes in this part of the tax system is that levied on communications and transport. The most conspicuous part of the revenue derived by the State from this source has been already considered in connexion with the industrial domain. Post offices and railways are apparently contributors to the economic rather than to the tax revenue. Nevertheless, it is possible to find in some cases a tax element in such receipts. The net earnings of the English Post Office are declared to be for 1901–2 £3,999,000, and of this amount, the far greater part, perhaps the whole, is obtained from correspondence. The rates for circulars and newspapers are not fixed on a profitable scale. It therefore follows that the excess of postal revenue over expenditure is a tax on ordinary and commercial letter-writers, but one of a very moderate nature, though it is not easy to estimate the check that a penny, as against a halfpenny, rate gives to trade.[1] Regarded as a tax diffused over the community, it

[1] See the discussion in *Memoranda on Incidence* [C. 9528] as to the nature of the postal revenue, and cp. *supra*, Book ii. ch. 3, § 9.

is on the whole defensible, though the tendency to insist that the postal profits shall be devoted to improving the service is already becoming more pronounced. That England, with its dense population and high industrial development, is very favourably situated for cheap postal working is undoubtedly true. Other countries have very little postal surplus to deal with; their difficulty rather consists in keeping up sufficient receipts to balance expenditure.

The Prussian state railways have been in an analogous position to the English Post Office. Such high net receipts as they have obtained could hardly be due to superior management: they rather suggest unduly high rates or inefficient railway service, and in the latter respect there appears to be reason for complaint.[1] A slight reduction in train service or delay in delivery of goods may reduce the cost of working, but proves very expensive and inconvenient for traders. For reasons stated before,[2] it is not likely that taxation of this kind will continue. The railway service, when under public management, will usually tend to be worked at such rates as will simply cover its cost.

In countries where the railway system is left to private enterprise the question of taxation takes a different form. The companies appear as the possessors of land, buildings, and rolling stock, as well as the recipients of income, and they (*i.e.* their shareholders) will naturally be taxed for both general and local purposes. Thus the English local rates and the income tax apply to them. Many American States employ a special corporation tax on railroads. But these charges can hardly be regarded as falling on transport, though the last mentioned has in some degree that effect. Nearer to our present subject are the English passenger duty and the French taxes on the transport of goods and passengers. The former, which is a kind of descendant of the duty on stage coaches, used to consist of five per cent. of the gross receipts from passengers, but by a series of

[1] See Foxwell and Farrer, *Express Trains*, 118 sq.

[2] Bk. ii. ch. 3, §§ 14, 19.

abatements and exemptions its yield has been lowered from £810,000 to £330,000, or more than half. The French taxes imposed after the war of 1871 have been removed from goods of slow carriage, but are still levied on express goods at five per cent., and on passengers at a very high rate (over twenty-three per cent.). For 1901 the receipts came to £2,486,000, or about seven times the English ones.[1] Several of the American state taxes on railways are based either on the net or gross earnings of the lines; the latter is plainly the English passenger tax in a more comprehensive form.

The questions connected with the incidence of this kind of taxation are somewhat complex. At first it might appear that the tax would simply be added to the passenger fares or goods rates, and would therefore fall on the travellers, or in the case of goods on the dealers, and finally through them on the consumers. On the other hand, it has been pointed out that railway rates and fares are not fixed by cost of service, but, on the principle of all monopolies, so as to get the maximum net return. Consequently, the rates being already at their highest profitable point will not bear any further increase, and a tax on transport will be really a tax on railway dividends.[2] The latter view, however, assumes too easily the absolute monopoly of railway business, and also that rates are in all cases placed at the point of maximum profit. The legal, and still more the moral, limits on the power of railway managers cannot be ignored, and they would compel at least the sharing with the users of the service of any gain obtained by the railways, as they would permit an increase in cases of new taxation. In countries where railway construction is still active, a tax as heavy as that in France would tend to check the opening of fresh lines, and therefore, in the shape of diminished

[1] The tax on bicycles recently imposed in France may be regarded as a tax on transport, but it is perhaps more correct to place it under the head of licences.

[2] Sidgwick, *Pol. Ec.* 574; Fawcett, *Pol. Ec.* 628–9. See for discussion of some theoretical varieties Edgeworth, *Economic Journal*, vii. 230–2.

railway accommodation, fall on the community. Everywhere the hindrance to fresh outlay would have the same effect, but in a less degree. Thus there is no reason to doubt that, with the high guaranteed dividends of the French railway companies, the tax on transport is shifted from them to the passengers and senders of goods, and in all cases an indeterminate portion falls on them. Such a form of taxation is very undesirable: like a charge on correspondence, it acts in restraint of trade, both with respect to goods and to business passengers. Even in the case of travellers for pleasure it is an impost on one of the most effective means of improvement. If railway earnings are to be taxed, it is better that they should be dealt with directly, either by requiring a price for the concession or a portion of the dividends. To trust to the uncertain action of shifting is not advisable where commercial interests may be seriously affected.[1]

The same conclusion may be extended to the treatment of telegrams and parcels. Unless on the ground of financial necessity, the effort to raise revenue from these factors of trade cannot be justified. The defence of letter-post taxation is to be found in its general diffusion, and in the fact that it is hardly perceived.

The treatment of the press and advertising agencies in respect of taxation may be next considered. Arising partly out of the system of control adopted by governments with respect to news, the taxation of newspapers by means of stamps was employed in England, France, and Prussia. Both the issues of newspapers and the advertisements in them were taxed. This impost was first established in England in 1712, at a moderate rate, but raised by degrees till, in 1815, it came to 4*d.* per sheet, while the duty for each advertisement was 3*s.* 6*d.* The latter was abolished

[1] Professor Ely advocates taxation of gross receipts in order to escape evasion. *Taxation*, 324. But where this danger exists a more thorough reform is wanted. Taxation of railways by American States on this basis is particularly unsuitable owing to inter-state competition. See Adams, *Finance*, 458–62.

in 1853, and the newspaper duty in 1855.[1] The Prussian tax was repealed in 1874, and the French one three years earlier. Austria, however, has retained the duty on newspapers.

The objections to such taxation are plain enough. To tax the press is to limit the diffusion of information and one of the means of popular education. It has the further defect of being very unequal in its pressure, and at the same time being very likely to become uneconomical, as a tax on journals reduces their sale and lowers their quality.[2] The advertisement duty was a direct check to trade, and prevented the growth of businesses relying on the custom of a large and scattered body of persons. These considerations, together with the small revenue from the duties—£500,000 at the highest (1815)—has made their repeal imperative, unless in countries where political reasons make the control of the press desired.

§ 3. We have more than once had occasion to refer to the employment of stamps as a part of the mechanism of taxation. A great many fees, the postal revenue, the Russian and American tobacco taxes, and the newspaper duty in England are or were collected in this manner. It is, however, in connexion with the taxes on acts that the stamp form becomes particularly prominent. So much is this the case that 'stamps' in England and the '*timbre*' in France are actually treated as distinct heads of revenue.[3] It is therefore important to state plainly that there is no separate stamp tax as such. The term merely denotes that the mode of collecting the taxes is by the use of stamps. This particular fiscal contrivance—first introduced in Holland in 1624—is peculiarly suited for levying taxes

[1] Dowell, iv. 338–47.

[2] Cp. Mill's judgment, 'A tax on newspapers is objectionable, not so much where it does fall as where it does not,' *Principles*, Bk. v. ch. 5, § 2. But does not a tax 'fall' where it is privative?

[3] See the heads of revenue in the annual *Statistical Abstracts*, where 'stamps' take a place beside 'customs' and 'excise.'

on acts or commercial dealings, and is on that account regarded as being their special feature. Modern European taxation uses it extensively, and sometimes combines it with the older method of registration at a public office. The great convenience of the stamp system results from the facilities that it gives for proportioning taxation to value. By grading the prices of the necessary stamps, the tax on any act or transfer can be adjusted to the amount dealt in, and the formalities are made easier and less cumbersome.

This system of stamp duties—as following English usage we may call it—covers a very wide field and is growing in favour. Extensions to fresh business forms, particularly in connexion with Stock Exchange transactions, have been carried out both in England and Germany, and higher rates are probable in the future. The chief groups into which the system may be divided are:—(1) Taxes on law proceedings and juridical acts; (2) those on the ordinary commercial instruments, on stocks, shares, etc.; (3) taxes on the sale of property, especially immovables; and (4) taxes on gratuitous transfers, including the large and important body of duties on successions after death. This arrangement is in some respects open to criticism, for commercial transactions involve transfers of property, and succession duties have certain points of difference from gifts, but it is convenient as supplying an outline of the classes of objects taxed, and need not be regarded as logically exact.

§ 4. The taxation of law proceedings is a development of the fees charged for judicial services. So far as the charge is merely a recompense for the actual expense that the proceedings cause, it may best be looked on as a fee, but if it is raised to a higher point in order to cover some of the general expenses of justice, it is rather special taxation levied on the class of litigants for the extra advantages it enjoys. Certain classes of the community make greater use of the tribunals, and such taxation compels them to contribute a part of the expense incurred for their use. More careful consideration shows the error of applying the rule of particular interest in this

way. The administration of justice is a general interest that affects rich and poor, litigants and non-litigants alike. A tax on legal process is a hindrance to the use of the tribunals, *i.e.* an obstacle to obtaining legal remedies. The arguments of Bentham on this point have never been refuted,[1] and it seems that the true course is to reduce the necessary fees to the lowest point, unless in the exceptional case of commercial courts, where a small contribution towards the permanent expense may perhaps be allowable. Nevertheless, most legal systems do, in effect, tax litigants. The English charges, so far as direct receipts are concerned, hardly exceed the level of fees, but there is a good deal of unnecessary cost in the methods of procedure that is burdensome to the parties and not productive of revenue to the State. France is in somewhat the same position; its strictly tax receipts are probably somewhat less than those obtained in England.[2] The German fees from the courts of justice also contain a tax element. The Prussian net receipts from this source were about £1,750,000 in 1868; £2,300,000 in 1894–5, and over £2,500,000 in 1897–8, though the part inclusion of non-contentious fees makes precise statement difficult. The intrusion of taxation into this part of administration should be carefully watched, which is most effectively done by revising the scale of fees at short intervals.

Taxation of juridical acts is open to objection, as in most cases they are necessary for the assertion of claims or rights, and graduation in proportion to value is hardly possible. It is, besides, unwise to put pressure on the poorer classes in connexion with what is so conspicuous a part of state action. The fee principle is the one really applicable to such cases, unless a measure of value can be found, when a proportional scale at a moderate rate may be used, if financial necessities require it. The method of stamps enables this policy to be carried out at the lowest cost, and with on the whole the least evasion.

[1] *Theory of Legislation*, 140; cp. Bk. i. ch. 3, § 2.
[2] Cp. Bk. ii. ch. 4, § 8.

The duties on juridical acts are not quite clearly separated from those on what we have called commercial transactions. The simplest relation between parties has its legal side; the giving of a receipt or the transfer of a share may be said to be an act of law, but in the great majority of cases this aspect of the transaction passes without notice, and the economic process attracts chief attention. Dealings in bills of exchange, bills of lading, shares, or stock, in the various forms that the modern money market presents, may be regarded as equally suitable objects for taxation with ordinary income, or the use of commodities. They have also the advantage, as it is thought, of falling on the circulation of wealth, and therefore corresponding to and supplementing the duties on the other departments of the economic process. Some recent advocates have discovered another useful function in that they are mainly levied on the gains from speculation (*Conjunctur-gewinn*), which, as being 'unearned,' are evidently a fit subject for taxation; while, finally, they present to the practical financier the pleasing prospect of a tolerable revenue without the social and technical difficulties that the taxation of income and commodities gives rise to.

The objections are, however, not to be lightly treated. All such duties are, it must be said, to some extent obstructive of trade. A tax on the formation of companies is so far a check to their establishment. Duties on the transfer of shares tend to keep capital from that particular form of investment, and to make these evidences of ownership less mobile. Even a small tax on cheques is a limit to the extension of banking, and a receipt duty is a charge on the evidence of an important class of transactions in which everybody is sure to be concerned. High rates are in fact an inducement to evasion, or to entire neglect of the requisite formalities, and therefore often cause injustice where claims are disputed. The problem raised by this part of the tax-system is, on the one hand, to avoid undue pressure on the circulation and transference of wealth, and,

on the other, to derive sufficient revenue to make the maintenance of the duties justifiable. From this point of view the English method seems the best—viz. that which raises a large revenue from low duties, and escapes unnecessary discrimination and complication by uniform rates, or at most a small number of scales. Great elaboration and minute distinctions between different classes of acts are productive of far more inconvenience to the taxpayers than of revenue to the State. Where, however, *ad valorem* rates can be easily applied, it is possible to combine simplicity and proportionality to value.[1]

One particular class of duties, that on the transfer of property, and especially on land and fixed capital, or, in legal language, 'immovables,' gives rise to still greater doubt and question. Heavy taxation on transfer has the effect of lowering the value of the articles subject to it, and prevents their ready passage from one owner to another. In the case of such important commodities as land and buildings, any result of the kind is detrimental to economic progress. One of the agents of production is hindered from reaching the possession of those who could best use it, and the total production of the country is less than it would otherwise be. High duties on land transfer are therefore forbidden by the strongest financial and economic reasons, viz. the injury they inflict on the national wealth, and by consequence on the public revenue. Fees sufficient to cover the cost of the legal machinery needed for transfer are legitimate, and where revenue is urgently required, a moderate transfer duty may be employed, just as, under like conditions, raw materials may be subject to excise or customs duties.

On the whole, then, it seems that the place of taxation on acts, whether by stamps or other machinery, is a subordinate one. It cannot wisely be used to collect as large

[1] Both in France and Germany popular feeling is strongly in favour of an extension of 'Bourse taxation,' as shown by the French law of 1892 and the German legislation of 1894 and 1900.

a revenue as either the primary taxes on income and property or the duties on consumption. A very wealthy community with large commercial transactions may be able to bear the levying of a toll on them, provided that it is kept within due bounds. The yield of the penny duties in England may be taken as an illustration, but it must at the same time be remembered that any injudiciousness in the imposition will cause a loss to the trading community, not easily perceived, but none the less present and real.[1]

§ 5. The regular history of the English stamp duties commences after the Revolution. By the Stamp Act (1694), duties varying from 1*d.* to 40*s.* were imposed on legal instruments, which were grouped in six classes, and each sheet of a document was separately taxed. Twenty years later some of the rates were graded in proportion to the value affected, and the duties were increased. Several other increases were made as financial necessities demanded, and the yield of the duties was larger.[2] Bills of exchange and promissory notes were brought under taxation in 1782, and receipts in the next year. Fresh increases followed in the time of the great war, and a great many complicated rates were established, until in 1815 the total yield was £2,800,000, of which £1,100,000 came from bills, notes, and receipts. Some reductions and improvements were made in 1850, and the penny receipt duty was introduced by Mr. Gladstone in 1853. The further progress consisted in a wider use of the system of low duties, a closer approximation to *ad valorem* charges in the variable duties,

[1] Some of the 'penny' duties devised by Mr. Gladstone erred in this respect; *e.g.* that on packages, justified by its author for statistical reasons. *Financial Statements*, 161, 295. The French statistical duties have the same defect. Leroy-Beaulieu, i. 617.

[2] The following are the figures for selected years :—

1714 . . .	£117,000
1727 . . .	160,000
1760 . . .	290,000
1778 . . .	442,000

Dowell, iii. 290-1.

and an extension to the new forms of documents and transactions that modern commerce had developed. The last-mentioned movement is hardly concluded, though recent legislation has left little to be done in the future, except in the task of removing anomalies. The yield from these different forms is now £7,500,000 annually, of which about £700,000 is received from bills and promissory notes, nearly £1,500,000 from the penny duties,[1] and about £3,600,000 from the taxes on deeds, sales, and securities.

The French system is older than the corresponding English one. The duties at present known as *enregistrement* and *timbre* can be traced back to a series of dues existing under the monarchy.[2] This was one of the forms of taxation that were in substance preserved by the Constituent Assembly, for though it abolished the old names, it retained the regulations under the new title '*enregistrement*,' and dealt with the two comprehensive classes of 'acts' and 'transfers of property,' including under these heads gifts and successions after death. Parallel with it were the stamp duties—first used in France in 1665—which were reformed in 1791. The field covered by this system is even more comprehensive than the English one. Transactions of all kinds are brought within the net of taxation by elaborate and complicated regulations. The legislation of the revolutionary period, which at first was ineffective, owing to bad administration, became more productive as settled conditions were restored. The duties of registration were separated into 'fixed' and 'proportional,' to which, since 1872, an intermediate class known as 'graduated' duties has been added. These groups, as their several designations show, consist respectively of uniform, of *ad valorem*, and of classified rates. In the corresponding

[1] In 1881 the postage and revenue penny stamps were combined, so that the exact receipt of the latter is now a matter of calculation.

[2] These charges were known as *contrôle*, *insinuation*, and *centième denier*. The stamp duty was known as the *formule*.

stamp system, the charges depend, either on the size of the document (*timbre de dimension*), or on the value dealt with, and for the former a scale is prescribed. Cheques, receipts, insurance policies, and other negotiable instruments of very varied kinds are brought under this charge.

As a result, the yield of the duties has been a growing one. In 1800 the total receipts were less than £2,800,000. By 1816 they came to £5,200,000, and in 1830 to £7,280,000. In 1860 they reached £14,500,000, and had in 1890 risen to over £28,000,000.[1] Their yield in 1901 exceeded £29,000,000. Out of this amount successions (which belong to the subject of the next chapter) and donations contributed £9,000,000, and the duties on land-transfer over £5,250,000.[2]

So great an increase—tenfold in ninety years, and nearly twofold between 1830 and 1860, and again between the latter year and 1890—is due to three distinct causes, viz. (1) the normal growth of wealth and transactions respecting it; (2) the extension of the duties to new cases; and (3) the establishment of higher rates; and, so far as the stamp duties are concerned, the effect of each has been about equal. There seems to be little doubt that in many cases the rates are far too high and the regulations too complicated.

[1] Stourm, i. 442–3, 468–9; Leroy-Beaulieu, i. 528, 533.

[2] The following figures give the result of the *enregistrement* and *timbre* for 1901.

	£ (000's omitted).
Transfers for value (movables)	2,886
,, ,, (immovables)... ...	5,258
Gifts	932
Successions after death...	8,000
Other duties (including fees)	5,400
Stamp duties (fixed)	5,000
,, (proportional)...	2,000
The Bourse tax	246

From this total the succession duties have to be deducted, and allowance has to be made for the element of fees under the 'other duties.' *Actes civils et administratifs* amount to £3,000,000, *Actes judiciaires* to £960,000. Probably one-half of these sums should be regarded as 'fees,' the other half as taxation.

Especially in the case of land-transfer is the first defect noticeable. The duties directly imposed on sale are nearly 7 per cent., and with the stamps and fees the total charge is over 10 per cent.—*i.e.* where land sells for thirty years' purchase it amounts to at least three years' income. Such a rate is open to the severest condemnation as tending to immobilise the most important form of property and thereby to reduce the productive power of the community.

The influence of French financial legislation on neighbouring countries has been considerable, and nowhere more than in Italy. The duties on transactions in that country have been formed on the same general lines as the *enregistrement* and *timbre*, and at first increased even more rapidly in their returns. From £1,400,000 in 1862 they rose to £3,600,000 in 1875, and advanced steadily until in 1887–8 they amounted to £5,500,000, at which point they have since remained, while the succession duties, which were only £280,000 in 1862, had become £1,000,000 in 1876 and £1,470,000 in 1887–8. Enlarged territory, higher rates of duty, and greater stringency in collection were the chief reasons for this growth of revenue.

Neither registration nor stamp duties have acquired as much financial importance in the German States. The transfer of land is not heavily burdened, and the methods of registration are devised for the convenience of the parties concerned. The succession duties are as yet confined to the separate States, but an imperial system of taxes on commercial affairs has been established. Bills of exchange, shares, credit instruments, and commercial transactions have thus been by degrees brought under moderate taxation, and developed by a series of measures in 1881, 1885, 1894, and lastly 1900. The stamp duty on 'exchange' yielded £500,000 in 1900. The more important 'Bourse tax' increased from £750,000 in 1885 to £1,300,000 in 1890 and to £2,700,000 in 1895. The yield in 1900 was a little less than in 1895.

The revenue obtained is very much below the English, French, or Italian receipts.

§ 6. The actual operation of the duties on transactions is not always capable of being precisely estimated, and in regard to some of the classes the question of incidence has given rise to much dispute. Very often a transaction has reference to some material commodity, and then a duty on it may plausibly be assimilated with an ordinary tax on commodities, and the same principles applied to its investigation. To levy a charge on transactions connected with production is, so far, an increase in the expenses of production that the producer and dealer will endeavour to shift to the consumer. In most of the taxes on receipts and bills the burden, falling as it does on trade as a whole, may be regarded as a tax on business gains. Whether any of it will be represented in higher prices to the consumers will depend on the extent to which the burden is unequally imposed, but under actual conditions this effect is not very likely to be experienced. The duties are too small a proportion of the total cost to have any influence on prices.

Where transfers of property are taxed the problem becomes more difficult, and there is room for doubt as to the real incidence of the charge. From one point of view it may be held that the purchaser, like the consumer of commodities, will in the long run bear the burden, and that therefore the price of land or shares would rise in proportion to the tax. Another view, represented by Adam Smith and J. S. Mill, assumes that in transactions with respect to land the seller is the more necessitous, and has, therefore, to reduce his price by the amount of the tax.[1] For a somewhat different reason this way of regarding the matter may be extended. Forms of property are purchased for the income that they yield, but the effect of a tax, so far as it is paid by the buyer, is to lower the return

[1] 'Taxes upon the sales of land fall altogether upon the seller.' *Wealth of Nations*, 364; cp. Mill, *Principles*, Bk. v. ch. § 1.

obtained, and besides to make the principal less saleable in the future. It might accordingly be supposed that purchasers would take all these elements into account, and place the whole weight of the present and future charges on the actual holders. The tax on transfer would in fact resemble a fixed tax on the object sold, such as the permanent land tax. There is, on the whole, good reason for believing that the incidence is divided between buyer and seller; the former gets less than he would receive if there were no tax, the latter pays more than he would on the same supposition,[1] and some persons keep out of dealing on account of the tax.

Where bills of exchange and commercial instruments, as stocks and shares, are affected, another result may be found. Taxation will tend to drive away floating capital from the countries in which it is imposed. A heavy tax on transactions in the London money market would be so far an inducement to shift them to another country. On this ground it is very undesirable to tax international stocks at higher rates than exist elsewhere. The utmost care is needed in limiting this form of taxation so as to avoid injurious action on capital.

[1] Suppose, for example, that a property, which free of duty would sell for £10,000, is subject to 10 per cent. on transfer. If the whole tax fell on the seller he would only get £9,000, if it all fell on the buyer he would pay £11,000. Is it not plain that if an exchange is to take place the probability is that there will be a division of the tax? When there are many transactions the less eager buyers and sellers will withdraw, and there will be fewer dealings at a higher price, the tax included. See Böhm-Bawerk, *Positive Theory of Capital* (Eng. trans.), 203-13, for the theoretical basis of this position.

CHAPTER IX

TAXES ON SUCCESSIONS[1]

§ 1. ONE large and productive form of taxation which actual legislation often combines with the transfer and stamp duties, but which is of such increasing importance as to require separate treatment, must now be considered. This is no other than the duties imposed on succession to property after death—in well-known English phraseology the 'death duties,' but also often described as inheritance taxes. Though such charges are undoubtedly levied on the transfer of property, and are usually—in part at least—collected by means of stamps, they yet possess peculiar features that mark them off from the imposts discussed in the preceding chapter. In the first place, they are not the result of ordinary commercial operations, and differ even from gifts in the circumstance that they are, in a sense, forced or compulsory. Again, the incidence of the duty is distinct from that in the case of ordinary exchanges, while, most significant of all, they amount to, and indeed are by some deemed to be, the best mode of carrying out a general tax on property. All these characteristics fully justify us in devoting some space to an examination of the growth and operation of the various taxes on successions.

The origin of these duties may be traced to the claim of

[1] See on the whole question of succession duties the careful monograph by Dr. Max West entitled *The Inheritance Tax*; A. Garelli, *L'Imposta Successoria*; and Schanz, 'Studien zur Geschichte und Theorie der Erbschaftssteuer,' *Finanz Archiv*, xvii. 1-62, xviii. 553-678.

the ruler to take possession of goods that had no owner, or with even greater probability to the feudal dues that were payable to the lord at each change of tenancy.[1] But in any case the full establishment of the State made the employment of any form of taxation possible. Recent discoveries have revealed the existence of an inheritance tax in Egypt under the Ptolemies and it may be of even older date.[2] Almost at the establishment of the Empire in Rome, we find the policy of death duties adopted by Augustus, who imposed a five per cent. tax on the inheritances of all Roman citizens except those passing to very near relatives,[3] a charge which extended with the widening of citizenship until it came in the third century to include all freemen. Modern States, more particularly in recent years, have largely developed the system with very varied scales and grades of duty, so that it has come to be almost universally regarded as an essential constituent in any well-arranged scheme of finance, and seems to be equally approved by popular sentiment and by the larger part of scientific opinion.[4] In spite of this weight of authority, both theoretical and practical, the difficulties to be encountered are by no means trivial and are such as to deserve attentive consideration.

§ 2. Succession duties first of all possess the grave economic fault of tending to fall on capital or accumulated wealth rather than on income; they therefore may retard progress. The force of this objection no doubt varies greatly with the economic position of the society and the habits of the people, but it is, nevertheless, always more or less in operation. The distinction between capital and

[1] Cp. Bk. ii. ch. 4, § 6. The 'relief' or 'heriot' was the commonest of the feudal dues.

[2] See the material collected in Wilcken Griechische Ostraka.

[3] This was the *vicesima hereditatum*, which underwent several changes until it was abolished in the sixth century.

[4] See the long list given by West, 112, n. 2. Some of the names might have been omitted as of little weight, and others, *e.g.* Leroy-Beaulieu, are those of very lukewarm supporters.

revenue is not indeed so rigid as Ricardo seems to have supposed, and there is some transference of taxation between these two categories of wealth.[1] But this in no wise invalidates the proposition that the levy of duties directly on capital tends to reduce the amount of that aid to production. To take a part from a given mass of wealth at the moment of acquisition leads the new possessor to look on the remainder as all that ever existed.[2] How far evil will actually result depends on the extent to which the accumulation of wealth has become automatic, and also largely on the amount of the duties levied. By placing succession duties at a sufficiently high point the process of saving would be stopped even in the most thrifty of modern countries. There is, therefore, a pressing need for observing due limits in the rates of charge in order to avoid such a danger.[3]

A second and more strictly financial difficulty arises from the risk of evasion that high duties are likely to cause. Unless gifts and sales are taxed at the same rates as inheritances there is a strong inducement to resort to transfers *inter vivos*, or special legal devices by which the liability to duty would be escaped. Here, again, the social and economic conditions are important. The disposition to avoid taxation even by legal means varies in different countries, and so do the forms of property to be dealt with. Thus the great increase of immaterial wealth, much of it

[1] Cp. Bk. iii. ch. 2, § 5, and Bk. v. ch. 5, § 9, for recognition of this fact. Professor Marshall declares that 'the old objection to taxes on inheritances that they are paid out of capital . . . seems to me to have great force still,' *Memoranda*, [C. 9528], 123.

[2] It is therefore impossible to accept Dr. West's statement, that 'Whether a tax is paid out of capital or income depends not on the form of the tax but upon its amount and the time allowed for payment' (*Inheritance Tax*, 119), unless we reduce the antithesis between the terms so opposed almost to vanishing point. The mere 'name' of a tax has of course no effect.

[3] The strongest body of sentiment in favour of high succession duties is that which regards them as an agency for reducing large fortunes, and thus bringing about a better distribution of wealth. In Bentham's language such persons desire to sacrifice 'security' to 'equality.'

of an international character, that has taken place in the last fifty years, supplies readier means of evasion should the possessors desire to use them. The attempt to guard the succession duties by a comprehensive taxation of all transfers is too obstructive to trade and commerce to be lightly adopted, but in case of difficulty it seems the only effectual mode.

So far as the smaller successions are affected, heavy taxation is objectionable in another way, inasmuch as it often presses very hardly on the payers at a time of need. This applies more particularly to inheritances by wives and children, but even in the case of collaterals it is sometimes a grievance. The dissolution of a household is a time of special demands, and the claim of the State may violate that canon of convenience which should govern the application of every form of taxation.

All these circumstances tend to support the proposition that duties on inheritances should not be carried beyond a moderate limit. There is hardly any form of taxation that would be more injurious in its ultimate effects, while at the same time the evils produced by it may not for a long time be attributed to their real cause.

§ 3. The true place of the succession duties in a developed tax system has given rise to much debate, and been the occasion for the promulgation of many ingenious theories.[1] We might choose between the application of the protection or *quid pro quo* theory, by which taxes on inheritances are merely the compensation of the State for the trouble of securing the due devolution of property, the essentially opposite one which regards the public power as a bandit levying the highest charges possible on those estates which have fallen into its hands, and the connected theory of the State as the rightful successor to all property, a portion of

[1] See West, 114–19, for a list of the different theories, also Seligman, *Essays*, 122–33, who holds that the tax is one on 'accidental income.' Schanz (*Finanz Archiv*, xviii. 172–6), after reviewing the earlier theories, bases this form of taxation on (*a*) the increase of ability in the payer, (*b*) the justice of heavier taxation on property, (*c*) the power of the State to limit inheritance.

which it graciously surrenders to those who claim by will or the ordinary rules of distribution in the case of intestacy. But to those who have followed the exposition of principles contained in earlier chapters, none of these one-sided doctrines will appear even plausible. Taxation on transfers after death is but one part of a general system designed to provide the funds needed for the maintenance of the State. It must conform to the general canons that govern the tax system, and it should be adjusted to the other component parts with which it has to make an harmonious whole. Assuming that we have a rule of distribution, the burden of succession duties should be so adjusted as, together with other taxes, to secure its observance.[1] From this point of view the chief difficulty with the succession duties is their necessarily irregular levy. Human life is uncertain in its duration, and, as Gladstone once asserted with his wonted impressiveness, 'no man can die more than once.'[2] Taking the average, however, we find that a fairly constant proportion of property passes annually by death, and we are thus led to regard the death duties as a capitalised income-tax levied only on accumulated wealth, and sparing those comparatively temporary parts of income that result from personal exertion.[3] So regarded, they may be progres-

[1] It is ingeniously suggested by Sidgwick that inheritance taxes are 'quite *sui generis*,' and therefore outside the rules for distributing general taxation. See his *Political Economy*, 577–9, and *Politics*, 176–7. But this view overlooks the close connexion between property and income, and also that between the successors and those from whom they inherit.

[2] *Financial Statements*, 62.

[3] The system of insurance so extensively advertised by British insurance companies to meet the estate duty of 1894 indicates very plainly that this is the essential character of the tax. This view is adversely criticised by Seligman (*Essays*, 132), on the grounds that (*a*) if the existing system (*i.e.* without the inheritance tax) does reach the living taxpayer, there is the injustice of double taxation; (*b*) if it does not reach him, there is inequality between persons dying at different ages. To which it may be rejoined that (*a*) it is because the existing system only partially reaches the taxpayer that the inheritance tax is introduced; and (*b*) that there *is* inequality in the case of persons dying at different ages, but this, like other inequalities, is hardly avoidable without incurring greater evils. Westlake recognises 'the fact that death duties may be regarded as capitalised income tax,' (*Economic Journal*, ix. 372), and holds that this view

sive as to their rate on the larger inheritances without losing the features that we have just described, and they may even be looked on as a partial realisation of the taxation of one form of accidental or unmerited advantage. Whether they should be employed in this way, or for the furtherance of any wider social ends, such as the better distribution of wealth, is a question, not of public finance, but of economic policy, though it may be said that the result of mixing up social and financial aims is not beneficial.[1]

§ 4. As applied in practice, the many taxes on succession present at first sight a bewildering variety that makes it almost impossible to regard them as being the outcome of scientific or administrative foresight, or indeed anything else than the result of temporary convenience or fiscal necessity. Closer investigation reveals the fact that they have been usually graduated on two different principles, viz. (1) that near relations should pay less than remote ones or total strangers, and (2) the later idea that large successions should pay a higher rate of duty than small ones, or progression in the usual sense. The former, which is found in nearly every system, rests on very old and long established sentiments. The feeling that the wife and children are, in a sense, joint-owners of the deceased's property, or at least have the best moral claim to succeed to it, is still powerful.[2] There is, besides, the already noticed fact that the death of the owner is a time when special outlay is required, so that heavy taxation would involve sacrifice and cause much irritation, and it would, moreover, form the strongest stimulus to efforts at evasion. Hence the com-

is in accordance with the principle of the British system. Lord Milner also declares, 'I regard the death duty as equivalent to an extra income tax on property.' 'Commission on Agricultural Depression,' *Evidence*, iv. 478 a.

[1] Cp. Bk. iii. ch. 3, § 17.

[2] Cp. the Roman rule as to disherison of children, justified by the jurist Paulus on the ground that there was a sort of co-partnership between the father and the children. See Pliny's remarks as to the *vicesima hereditatum*, which was '*tributum tolerabile et facile heredibus extraneis, domesticis grave*, since it was levied on goods '*quaeque nunquam ut aliena et speranda, sed ut sua semperque possessa cepissent.*' *Paneg.* 37.

plete agreement as to the principle of lower rates in the case of successions by near kin, with at the same time very great differences in the allowances actually made in different financial systems.

Of much greater interest at present is the principle of progression as applied to succession duties. We have already considered the general question,[1] but, as in the case of the income tax, some special points are best noticed here. The hope of promoting a better division of wealth has led some opponents of progression to approve of its use in this case.[2] Some of the technical difficulties that make progression unsuitable in the case of the income tax are not found here. A return of the total wealth of the deceased must in any case be made, so that the assessment of the duties is comparatively easy. The executor or administrator through whose hand the property passes is, besides, often not interested at all, or very slightly, in evading the duty. Other difficulties no doubt remain. Consideration has to be given to the effect of high duties on the minds and habits of those who are the accumulators of great stores of wealth. They may be influenced to reduce their savings to the injury of the society, or they may employ the various means of evasion that their legal advisers or their own ingenuity may suggest. But behind any actual scale of progression lies the unavoidable danger of arbitrary extension in the future. There is as yet no limiting principle discovered which will determine up to what point progressive death duties shall be carried, and at which their advance should cease. Appeals to the supposed natural rights of owners, or to the equally imaginary rights of the State, can supply no solution of this problem.[3]

[1] Bk. iii. ch. 3, §§ 6, 7, 8.

[2] *E.g.* J. S. Mill, who declares that 'The principle of graduation . . . seems to me both just and expedient as applied to legacy and inheritance duties.' *Principles*, Bk. v. ch. 2, § 3.

[3] The only scientific bases for progressive succession duties would be (*a*) the establishment of the regressiveness of other taxes, so that in this case a duly calculated progression would restore proportionality, and (*b*) the proof of the

§ 5. The history of the English death duties begins with the Stamp Act (1694), which placed 5*s.* on probates over £20. This uniform charge—doubled four years later—continued till 1779, when three scales of duty were introduced. The usual process of increase was carried on, and the *ad valorem* principle was reached by gradual approximation in 1889. After that date the duty stood at three per cent., imposed on all probates and letters of administration. The old arrangement by which a maximum duty was fixed at a certain point[1] disappeared, and very small estates—those under £100 and £300—received special allowances. This direct charge on the estate was protected by the account duty—devised by Gladstone in 1881—which was introduced to check evasions, and applied to gifts made within a year of death. Those duties did not include real or settled property, and they therefore failed in comprehensiveness.

The legacy duty, first imposed in 1780, developed in the same way. Though a charge on the receiver of the bequest, it is, like the income tax, in many cases to be paid from the source, that is the estate, and deducted in the payment. Unlike the old probate duty with its practically uniform scale, or the new progressive estate duty, it varies according to degree of relationship, and does not, since 1889, apply to descendants. Its highest point, ten per cent., is reserved for strangers and very distant relatives.

The parallel tax on realty and settled personalty, the succession duty, only dates from 1853. Pitt had failed to establish a tax of the kind in 1796, and it was with great difficulty that the budget plan of 1853 was carried. It amounted to an

justice of progression on an assigned scale over the whole tax system. It was on the former ground that Lord Goschen defended his estate duty of one per cent. on estates over £10,000. He declared that 'On the whole, I think it will be found that the men whose fortunes are considerable are those who pay the least in proportion to their aggregate income.' Budget Speech, April 18, 1889.

[1] This limit was raised from £5,000 to £10,000, then to £100,000, next to £500,000, and lastly, in 1815, to £1,000,000. It was abandoned in 1859.

extension of the legacy duty to successions hitherto exempt.[1] This undoubtedly just proceeding failed at first to accomplish what was expected; instead of the estimated £2,000,000, its average yield has been about £700,000, or, roughly speaking, one-third of what was anticipated. The great number of lineal successions and the exemption of debts from the duty explain this failure.

Another and, as it proved, very temporary addition to this group of taxes was the estate duty of 1889, which was a supplement of one per cent. to the probate and succession duties when the property exceeded £10,000.[2]

The system of death duties as it thus stood in 1889 was extremely complex, and presented some striking anomalies.[3] The separation of real and personal property, and the favourable treatment given to the former,[4] appeared at first sight a gross injustice. Plausible reasons, and especially the alleged heavy local taxation of land, might be put forward in mitigation, but the striking fact of inequality remained untouched. Settled personalty also, and with less justification, escaped its proper share of the death duties, with the natural result of encouraging the tying-up of property, and thereby producing economic and financial loss. There was, too, an unnecessary amount of complication in the number of duties and in the minute distinctions drawn as to the different interests in property. These defects led to a very general recognition of the need for simplification and amendment, a task which was attempted, and in part achieved, by the Finance Act of 1894.

§ 6. This important and carefully conceived measure dealt with most of the points that we have indicated above.

[1] 'We propose to alter the law and . . . to extend the legacy duty to all successions whatever.' Gladstone, *Financial Statements*, 62.

[2] For the history of the English death duties, see Dowell, iii. 124–140.

[3] See for a lucid but one-sided statement of these anomalies Lord Farrer's *Mr. Goschen's Finance*, 117 sq.; also *A Handbook to the Death Duties*, by Messrs. Buxton and Barnes.

[4] Real property paid no probate duty; succession duty on it was not due for a year after death; it could be paid by eight instalments, and it was calculated on the successor's life interest only, not on the full value.

For the probate or account duty, applicable to unsettled personal property only, it substituted a new and all-embracing charge (which also included the estate duty of one per cent. established five years before), to be imposed on 'all property, real or personal, settled or unsettled,' and thus at a stroke removed the exemptions complained of, while reducing the number of duties. A second sweeping change was the valuation of real on the same basis as personal property, a provision which extends to the assessment of succession duty, if the successor is 'competent to dispose of' the property. Interests in real property will therefore be charged at their full commercial value, and the privileges as to time of payment are curtailed. Settled property passing at death also comes under charge, and contributes to swell the aggregate amount of the estate. Settlements are in addition subjected to a penalty charge of one per cent. over and above the estate duty on their transfer.

So far the changes have been in accordance with the principles admitted by all students of the subject, but the next alteration is of a more questionable character. The imposition of duty on the several forms of property making up an estate is accompanied by their 'aggregation,' a process essential for the ascertainment of the rate of estate duty, since it varies with the aggregate amount, beginning at one per cent. and ranging up to eight per cent. in the case of millionaires.[1] This is a direct introduction of progression into one part of the tax system, and the advocates of the measure have approved of it chiefly on that ground. We need not reconsider the vexed question of progression, but it may be noticed that the effort to

[1] The scale of duties is given in the following table :—

Value of Estate. £	£	*Rate of Duty.*	*Value of Estate.* £	£	*Rate of Duty.*
100 to	500	1 %	75,000 to	100,000	5½ %
500 ,,	1,000	2 %	100,000 ,,	150,000	6 %
1,000 ,,	10,000	3 %	150,000 ,,	250,000	6½ %
10,000 ,,	25,000	4 %	250,000 ,,	500,000	7 %
25,000 ,,	50,000	4½ %	500,000 ,,	1,000,000	7½ %
50,000 ,,	75,000	5 %	over	1,000,000	8 %

apply it is the cause of most of the technical difficulties surrounding the measure. The elaborate forms of account to be furnished by the executor are necessitated by the principle of aggregation. The sum of property 'passing on the death' is a vital element in the assessment of the duty. The comparatively small amount of £1,000 added to an estate of £1,000,000 would increase the duty £5,000. Hence the care and scrutiny required as to the exact total. For the same reason the inclusion of property situated abroad becomes very desirable, but it cannot fail to raise difficult questions of 'double taxation, which may even lead to international difficulties.'[1] More serious practically than either of the foregoing is the uncertainty that must attend a good deal of the taxation under this system. The rate of duty payable by A may depend on B's being brought to account for his portion of the estate, a proceeding which may not take place for years. The older duties were sufficiently irksome, and often pressed hardly on innocent persons. Future experience will probably show a great increase of troubles in this respect. Another effect of the system of aggregation combined with progression, in the case of the larger estates, is to place a heavier burden on the receiver of the residue, even though this be of moderate amount. It is quite possible that the whole surplus might disappear under the action of the law, but to avoid this grievance it would be necessary to make the legacy and succession duties vary with the scale of the inheritance.[2]

The treatment of landed property, though on the whole in accordance with sound principles, is open to some question. Local rates and taxes are no inconsiderable items in the burdens on land, and some allowance should be made for their existence. Assessment on capital value, though theoretically fair, tends to fall heavily on an object

[1] As seems to have been the original design. Cp. the section of the Act, 57–58 Vict. ch. 30, § 14, with clause 12 of the Bill as introduced.

[2] On this point cp. Bk. iii. ch. 3, § 14.

which can only yield a small annual return. To ask at once the equivalent of three years' income is distinctly contrary to the canon of convenience. It might indeed be suggested that an annual tax on land equal in amount to the average death duties should be substituted for them, or arrangements might be made for their commutation into such a charge at the owner's option. At all events, it seems evident that the measure of 1894 has not succeeded in dealing with all the problems that death duties inevitably create.[1]

§ 7. But whatever be the difficulties surrounding the future of the British death duties, there can be no question as to their value as a steadily growing branch of revenue. The increase during the present century has been very large. Before the changes of 1894 the total return—including the amount allotted to local taxation—reached in the year 1891–2 the amount of £11,000,000. After a slight falling off in the three following years, the new maximum point of £14,088,000 was reached in 1895–6. A loss of £125,000 in 1896–7 was followed by an advance in the next three years to £18,473,000 in 1899–1900. The year 1900–1 only gave £17,090,000, but 1901–2 almost touched the highest point obtained with a yield of £18,398,000.[2] In spite of occasional irregularities, the yield is at once fairly reliable

[1] One very difficult question is the relation of the death duties to local finance. Lord Goschen's allocation of half the probate duty has been continued under the present system, with the substitution of 1½ per cent. of the new estate duty. This substitution, however, altered the character of the charge, which ceased to be on personal property (to which the 'probate' duty was confined), and instead fell on all the mass of wealth passing by succession. See 'Local Taxation Commission,' *Final Report*, 114.

[2] The growth of the total death duties is best seen by the date at which each additional million was reached—

Year.	£ (000's *omitted*).
1813	1,005
1828	2,117
1856 7	3,121
1865–6	4,303
1871–2	5,360
1876–7	6,024
1881–2	7,249

and progressive; so that this class of duties may take place with the income tax as an important contributory to the direct taxation that is needed to counterbalance the excise and customs. This very function makes it all the more necessary to avoid rash experiments that might impair the efficiency of this part of the tax system.

§ 8. By means of the elaborate system of registration the French succession duties have been treated as a subdivision of the taxation on tranfers of property. This arrangement brings gifts *inter vivos* and successions after death under a common system, which is convenient, owing to the characteristics of the *Code Civil*, but it presents the economic disadvantage of hampering the movement of property. Starting from 1790, the duties on succession were somewhat increased by the measures of 1798, 1816, 1832, and 1850, the latter establishing the same rate of duty for 'movable' as for 'immovable' property (the former, contrary to the English rule, having been previously favoured). The Franco-German war made a general increase of 25 per cent. necessary; but with this addition, the scheme of succession duties continued unchanged to the end of the nineteenth century. The charge on descendants was more moderate than in England, that between husband and wife somewhat higher. Brothers, sisters, uncles, and aunts paid over 8 per cent.; complete strangers 11¼ per cent. In the actual working of the system several grievances were created, for (1) inheritances were taxed on their gross, not their net, value, (2) no allowance was made for debts, (3) when property was divided into a usufruct, or 'life interest,' and a 'reversion,' the life tenant paid one-half of the duty, the reversioner paying the full charge, while

Year.	£ (000's *omitted*).
1887 8	8,241
1888–9	9,378
1891 2	11,093
1895–6	14,088
1897–8	15,327
1899–1900	18,473

(4) land was estimated at twenty-five times its annual return for the purpose of the duty.

These defects, together with the strong desire of advanced politicians to introduce a progressive scale of charges, led to a series of attempts to radically reconstruct the French succession duties. After a number of failures the budget law of 1901 provided for the recognition of net value as the basis of assessment (with certain exceptions), and also for the deduction of debts. It further divided the duty between the usufructuary and the 'bare proprietor,' according to definite rules. But the most important change—or at all events that which attracted most attention—was the revision of the scale of duties on a progressive basis. Under the new system, somewhat extended in 1902, the duty varies with (1) the relationship, and (2) the total net value of the property received by the successor, and in some cases goes as high as 20½ per cent.[1] The financial results of this change will be interesting as an illustration of the working of progressive taxation, especially if taken

[1] The following table gives the scale of duties under the laws of 1901 and 1902; the latter introduced the progression on inheritances exceeding £40,000. It is instructive as showing the arbitrary way in which progressive taxation can be applied. Cp. Bk. iv. ch. 3, § 7, for this point.

	£40 to £80.	£80 to £400.	£400 to £2,000.	£2,000 to £4,000.	£4,000 to £10,000.	£10,000 to £20,000	£20,000 to £40,000.	£40,000 to £80,000.	£80,000 to £200,000.	£200,000 to £400,000.	£400,000 to £2,000,000.	Above £2,000,000
	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.
Descendants	1	1.25	1.5	1.75	2	2.5	2.5	3	3.5	4	4.5	5
Husband and Wife..	3.75	4	4.5	5	5.5	6	6.5	7	7.5	8	8.5	9
Brother and Sister	8.5	9	9.5	10	10.5	11	11.5	12	12.5	13	13.5	14
Uncle, Aunt, Nephew, Niece	10	10.5	11	11.5	12	12.5	13	13.5	14	14.5	15	15.5
Grand Uncle or Aunt, Grand Nephew or Niece, First Cousins ..	12	12.5	13	13.5	14	14.5	15	15.5	16	16.5	17	17.5
Relatives of 5th or 6th degree.....	14	14.5	15	15.5	16	16.5	17	17.5	18	18.5	19	19.5
More remote relatives or strangers..	15	15.5	16	16.5	17	17.5	18	18.5	19	19.5	20	20.5

in comparison with those of the English Finance Act of 1894, which was in part the model on which the French legislation is framed.

But with all their defects the former French duties have proved a productive part of the revenue system. Their yield in 1891 exceeded £7,700,000, they rose to £8,400,000 in 1892, with some fluctuations in intermediate years they advanced to £9,000,000 in 1900, and stood at £8,000,000 in 1901.

§ 9. The Italian succession duties resemble the French (as they existed previous to the recent change),but are rather higher on lineal successions, and a little lighter in other cases. Deduction of debts, if proved on good evidence, is allowed. The receipts from this source increased from £1,000,000 in 1876 to £1,470,000 in 1890–1. The yield in 1900-1 was £1,590,000.

Though the German States nearly all levy succession duties they are of a very moderate character. Descendants are generally exempt,[1] and in Prussia ascendants as well as the husband or wife are also free. The highest point in most States is eight per cent. Alsace-Lorraine imposes nine per cent. on strangers. Baden, Hamburg, Hesse, Lubeck, and Oldenburg go as far as ten per cent.[2] The example of England and France will probably lead to an extension of these taxes, but proposals in this direction have as yet been decisively rejected by the legislatures.

Switzerland was long remarkable as being the only continental country possessing progressive succession duties. This feature, which is quite in accordance with the system of income and property taxes already described,[3] only appears in cantonal taxation, and varies much from canton to canton. In some the duties are proportional and light, in others high and progressive. Thus in Uri a

[1] Hamburg, Lubeck, and Alsace-Lorraine are the only exceptions; the latter possesses a modified form of the French law of 1870.

[2] See the valuable tables in *Finanz Archiv*, xviii. 679–695.

[3] See Book iv. ch 4, §§ 2, 8.

stranger receiving £40,000 has to pay £30,000 in duties. But, as Schanz significantly remarks, 'so high a property is not found there.'[1]

The Australasian colonies have signalised themselves by a very active employment of progressive death duties, reaching in some instances to 20 per cent.[2] It should, however, be remembered that direct taxation generally has been very little developed in Australia, owing to the great preponderance of customs duties and to the large proportion of gross economic revenue.[3]

§ 10. In the United States the inheritance tax has been chiefly developed in 'State' legislation. Beginning with taxes on collateral successions some legislatures have advanced to duties on direct successions, combined with progressive rates. Thus New York imposed a 'direct' tax of one per cent. on personal property over $10,000, Ohio followed with a progressive tax on direct successions (which was declared to be unconstitutional), and a uniform tax on collaterals. The example so set has been followed by a number of States, Minnesota, Nebraska, Washington, and Utah being the latest cases of imitation. It is highly

[1] *Finanz Archiv*, xviii. 637. For a fuller account of the facts respecting continental inheritance taxes see, besides the articles of Schanz, West, *Inheritance Tax*, ch. 1. It is impossible to follow the many small changes in the various States.

[2] The first to draw public attention to these remarkable experiments was Sir C. Dilke. *Problems of Greater Britain*, 513–4.

[3] The following table gives the proportional contribution of the different heads of revenue in the Australasian colonies for 1890 :—

Colony.	*Customs.*	*Other Taxation.*	*Economic Revenue.*	*Total.*
New South Wales	19·88	9·05	71·07	100
New Zealand	36·50	15·16	48·34	100
Queensland	38·13	7·02	54·85	100
South Australia	23·56	7·33	69·11	100
Tasmania	43·41	16·53	40·6	100
Victoria...	30·27	8·71	61·02	100
Western Australia	44·06	5·28	50·66	100

It thus appears that the yield from succession duties, which are only one part of the non-customs taxation, is very small. See *The Victorian Year-Book* (1892), i. 231.

probable that nearly all the American States will adopt this tax in some form or other.[1] There are, however, difficulties to be encountered. The constitutions of some of the States, which declare that taxation must be 'uniform,' prevent the employment of progressive or graduated rates.[2] Then, the economic conditions are not favourable. The interstate mobility of capital is so complete that the strict enforcement of a heavy progressive tax on successions, especially in the case of immaterial wealth, seems almost impossible. Hence, at first sight, the conclusion appears justified that inheritance taxes are, on the analogy of the income tax, better suited for 'Federal' than for State administration. Competent opinion in America is, however, agreed in approving of the attribution of the inheritance like the corporation tax to the States,[3] and this judgment must be regarded as conclusive.

The Federal Government has confined the use of the inheritance to times of war. In 1898 a duty was laid on successions exceeding $10,000. Descendants, brothers and sisters, were taxed ¾ per cent., for more distant degrees the rates increased up to 5 per cent. In regard to amount, successions over $25,000 paid one-half more; those between $100,000 and $500,000 paid double; the next class—those up to $1,000,000—paid two and one-half times; finally in the case of successions over $1,000,000, the original tax was tripled. The validity of this law was questioned on the ground that as a 'direct' tax it was outside the competance of Congress; but it was upheld by the Supreme Court, to the surprise of those who had followed the arguments on the income tax cases.[4]

[1] See Seligman, *Essays*, 133 n. for a list of States using the inheritance tax in 1895. On American state legislation, see West, ch. 3.

[2] Minnesota amended its constitution to remove this obstruction.

[3] This is the judgment of Professor Adams (*Finance*, 504, who, however, suggests a claim of the smaller local bodies), Professor Seligman (*Political Science Quarterly*, xiv. 139), and Professor Taussig (*ib.* xiv. 123).

[4] Professor Adams, in discussing the allocation of taxation, remarks, 'The Federal Government would be excluded, because under the rule imposed by

On the whole it may perhaps be said that, bearing in mind the peculiarities of the American Constitution and the actual economic conditions of the country, the States are the best organs for levying the duties on successions, but this makes it all the more important that the dangers of the progressive system should be avoided, and that there should be inter-state agreements establishing similarity of rates, and providing for equal and reciprocal treatment where property in different States is concerned.[1]

§ 11. The problem of incidence might first be supposed not to arise at all in this connexion. 'Taxes upon the transference of property from the dead to the living,' said Adam Smith, 'fall finally, as well as immediately, upon the persons to whom the property is transferred.'[2] But this view altogether neglects the ulterior effects on the distribution of wealth that the duties may bring about. If, as Ricardo argued, they fall mainly on capital, it is evident that the whole society suffers by less efficient production, and it is also probable that the higher value of the remaining capital will lead to a rise in interest and a consequent fall in wages. Hard as it may be to trace these results in any actual case, yet, given the conditions, they must be in existence. The pressure of existing death duties on capital is not, however, so clear. The English receipts of over £18,000,000, or the French of £8,000,000, are but a small part of the annual savings (not more than 6 or 7 per cent.). Even if we suppose that the whole amount would be added to savings the effect would not be important. This, however, could not happen, as an equal amount of

the Constitution it cannot justly make use of direct taxation,' *Finance*, 504. From the economic point of view this is correct, but it may be questioned whether there is any justice in this interpretation of the constitutional rule. See W. H. Dunbar (*Quarterly Journal of Economics*, xv. 292–8) on the legal question. It is interesting to notice that under either French or German law a succession duty is certainly 'indirect.'

[1] See the Massachusetts Tax Commission (1897) Report, in which a uniform inheritance tax is recommended. *Report*, 93–4.

[2] *Wealth of Nations*, 364.

taxation would have to be imposed in other directions, and it would in some degree trench on capital.[1]

On the whole, we may best regard the succession duties as presenting a parallel to the income-tax. The latter withdraws annually for the service of the State a portion of the new wealth created in the period; the former operate in the same way, but at uncertain intervals, on the collective wealth of the society.

[1] See on this question the discussions in *Memoranda on Incidence* [C. 9528], especially 88 (Courtney), 105 (Sidgwick), 133 (Edgeworth).

BOOK V

THE RELATION OF EXPENDITURE AND RECEIPTS

CHAPTER I

INTRODUCTORY—STATE TREASURES

§ 1. THE preceding books have been devoted to the consideration of the various questions connected with public expenditure and revenue. We have seen that, under normal conditions, there ought to be a balance between these two sides of financial activity. Outlay should not exceed income, or—and this is more often the way in which the case is presented—tax revenue ought to be kept up to the amount required to defray expenses. The financier, so far differing from the business manager, should not aim at a surplus, but neither should he allow a deficit. Either is an indication of some defect in calculation or administrative system.

This general principle must, however, admit of modifications. Temporary deficits and surpluses cannot be avoided. In the management of a large financial organisation complete equalisation of receipts and expenditure could hardly ever be obtained, or, if it were, would be due to chance. The many different forms of expenditure and the varying productiveness, both of the quasi-private and the tax revenue, forbid minute agreement. All that can be claimed is a substantial approach to a balance in the two sides of the account. The safest rule for practice is that which lays down the expediency of estimating for a moderate surplus, by which the possibility of a deficit will be reduced to a minimum.

The foregoing consideration would apply to any system

of finance in its ordinary or usual state, but the difficulty of adjustment is much increased by the operation of what has been described as extraordinary outlay.[1] Occasions, as we saw, will from time to time arise, when it becomes necessary to spend large sums for particular objects. War and the execution of public works are the great causes of this sudden increase of expenditure, and the former is very hard to foresee and provide against. In any case it may fairly be said that exceptional charges of the kind should not be altogether met out of current income. As the advantages realised are of indefinite duration, it seems fair that the charge should, in popular language, be spread over a number of years. Without at present criticising this doctrine, we may remark that the political conditions place limits—elastic ones, it is true—on the revenue-collecting powers of the administration, and that in practice there are only two expedients for meeting abnormal outlay, viz. either the modern method of incurring debt, or the older one of storing up treasure or other disposable wealth for the time of need. The absence of equilibrium in public finance must show itself in the creation of a surplus store of wealth, or in the formation of liabilities. In the present chapter we shall therefore examine the policy of forming public treasures or other reserves, in order to provide for the necessities of the State in times of emergency.

§ 2. The system of public treasures can lay claim to a high antiquity. Thus the Athenians in the period immediately preceding the Peloponnesian war accumulated a sum of 9,700 talents, and at its outbreak had actually 6,000 talents in store. Even earlier, the Persian sovereigns had collected the tribute of their provinces in the shape of contributions of the precious metals, large stocks of which fell into the hands of Alexander.[2] The same policy of hoard-

[1] Cp. Bk. i. ch. 8, §§ 1 sq.

[2] Thucydides, Bk. i. ch. 13; Grote, *Hist. Greece*, xi. 498–500; Roscher, § 124, n. 1.

ing was followed by the Romans. The stores of conquered sovereigns were accumulated, and the special tax on the emancipation of slaves was used in the same way. Indeed, the possession of the treasury became a leading object of the rival parties in the civil wars that overthrew the Republic.[1]

Like facts are noticeable in the mediæval period. One of the first objects of the successor to the Crown on the death of a king was to gain possession of the treasure. Both in England and France there were several instances of this eagerness.[2] The treasure and the kingdom were regarded as a joint possession, each being in accordance with the conceptions of the time, looked on as equally a form of property. This practice lasted in England till the time of Henry VIII., who speedily dissipated the savings of his prudent father. Henri IV., who in this was guided by Sully, was the last French monarch who maintained a treasure.[3]

By the time of Adam Smith the practice had decayed; he notes that the canton of Bern was the only Republic, as Prussia was the only monarchy, that continued to keep a reserve.[4] The latter country has been remarkable in this respect. Thus Frederick William I. (1713–1740), as Carlyle tells us, 'Yearly made his own revenues, and his people's along with them, and as the source of them, larger: and in all states of his revenue he had contrived to make his expenditure less than it; and yearly saved masses of coin and "deposited them in barrels in the cellars of his *Schloss*."'[5] His successor, Frederick the Great (1740–1786), continued this system, and it affords a striking instance of the persistence of national policy when we find that the present German Empire follows what is virtually the same method.

§ 3. The reasons that induced so many States to accumu-

[1] Roscher, op. cit.; Merivale, *Romans under the Empire*, ii. 169.
[2] Sinclair, *Hist. of Revenue*, i. 76. [3] *Wealth of Nations*, 386.
[4] *Ibid.* [5] *Frederick*, i. 290

late treasure are to be found in the conditions of society existing at the time. A very rude community will have no need of a store of money; weapons and provisions would be more useful in its case. The system of money dealings must have come into being before hoarding can be regarded as the duty of a wise sovereign. Once that point has been reached, the great convenience of having a stock of a universally desired article on hand is too plain to be overlooked. The efficient maintenance of an army in the field depends in a great degree on the supply of what is so often called the 'sinews of war.' Cases are not unknown where expeditions failed altogether from want of this indispensable auxiliary. The superstitious reverence for the precious metals and the force of habit may partly account for the great treasures of ancient States; but they owe their continuance far more to their felt necessity. Where credit was undeveloped, and taxes were occasional and uncertain expedients, a State that had no treasure was in a dangerous situation, unprepared either for attack or defence. The position of the sovereign in earlier times as a large property-holder was contributory to the same result. Lands, forests, mines, and various lucrative claims were in the possession of the ruler. The treasure came to be looked on as one part of this extensive class, serving a particular purpose and completing the public economy.

As the system of state hoarding was produced by the economic conditions of the periods in which it was employed, so the change to the modern economic organisation necessarily led to its abandonment. The increased productiveness of taxes, and the facility with which credit could be used, relieved governments from the duty of keeping a stock of bullion for emergencies. The State ceased to be its own banker, and came to rely on the instrument supplied by the growth of credit. Not only were the ultimate advantages greater, but there was an immediate benefit in the saving of the amount required to replenish the store, when it had from any cause run down.

Borrowing in times of need was more pleasant than a long course of previous saving. The change was, as we have seen, as gradual as the alteration in the ruling conditions that produced it. The keeping of stores of bullion died out slowly, and has even left, as in the case of Germany, survivals to the present day. This last instance deserves some further notice. The traditional policy of storing up a reserve for the pressure of war was applied to the German Empire by means of the resources obtained through the French indemnity. A sum of £6,000,000 was held in bullion and a much larger amount was invested in high-class securities, chiefly German railways and the debts of foreign countries. The 'fund for invalids' in 1901 amounted to over £19,000,000. There is, therefore, a reserve of over £25,000,000 held by the Empire in what is practically the form of a hoard, and apparently ready for use in time of war.

German economists have defended this proceeding on the ground that it is imperatively required for military necessities. The use of the treasure in the past is dwelt on, and it is further urged that at the outbreak of war the money market is so strained that a large loan is costly, if not unobtainable. The treasure or war chest is but the complement of the fortresses, equipment, and system of speedy mobilisation that constitute the safeguards of German unity.[1] On the other hand, the general argument against state reserves is a forcible one. The retention of bullion by the State involves the loss of the interest that could be gained by its productive employment, while it is quite uncalled for in any country with an efficient system of banking. What is really required is a sufficient disposable metallic reserve to be drawn on in the time of trial. The state-treasure policy thus invades the domain of banking, and is at best inadequate. Three weeks of war would exhaust the store of £6,000,000 now held at Spandau.[2] It

[1] Roscher, § 124; Wagner, i. 173-7; Cohn, § 169.
[2] Cohn, § 169.

is so hard to measure the precise amount needed, and error in either direction leads to such loss, that the policy is too uncertain in its effects to be advisable. The influence of state hoarding on trade and prices should also be considered. The withdrawal of a large mass of money tends to lower prices, and is so far a hindrance to the development of trade and the ever-present possibility of its sudden use has a disturbing effect.[1] On the whole, then, it is beyond question that in any country with modern credit facilities the formation of a treasure is a mistaken proceeding. The case is still stronger against the use of a reserve in the form of securities. They, it is true, have the advantage of yielding interest, but where a public debt exists, it is better to use this available property for its redemption. To borrow with one hand, while lending with the other, is simply introducing an additional complication into the public accounts, without any corresponding advantage. The repayment of a portion of the German debt would be as much an investment as the policy actually pursued. But the method of investing in securities is not merely useless; it has direct disadvantages. If home securities are chosen, the State is drawn into the business of speculation and stockjobbing, with injurious results to trade. The interest on such investments may apparently exceed what would be saved by paying off debt; but this higher yield means diminished security or stability, a consideration that leads to another objection to such investments. The aim in view is the possession of a disposable fund for emergencies, but it is just at times of emergency that stocks are most likely to fall in value. A large sale of securities by a government at the outbreak of war would force down their price, and make the process of realisation a costly one. Moreover, the funds so obtained would be equally available for taking

[1] The accumulation of silver by the American Treasury, though primarily a matter of policy rather than one of finance, has in the last few years been a disturbing element, and has affected both the trade and the revenue of the country.

up a loan. To come on the market as a needy seller is the worst possible way of disposing of any kind of state property.

Where foreign securities are held the position is somewhat different. They will not be so much affected by the commencement of war, as they possess an international market. Political difficulties are, however, greater. Should the contemplated war be with the Power whose debt is used as an investment, the question of stoppage of interest would arise. In any case the relation between the investing and lending States is not a satisfactory one: it brings a sovereign power into the domestic affairs of another State, and in case of readjustments affecting the debt may cause grave difficulties. These considerations fully support the opinion that, speaking generally, the system of state treasures or reserves of securities is indefensible at the present stage of financial development.

Some exceptional cases have been suggested, but even they can hardly be admitted as modifying the principle just stated. A State, *e.g.*, may have no public debt to redeem, and then the formation of a reserve may appear desirable, but there are other alternatives, viz. either (1) the remission of the less eligible forms of taxation, or (2) the increase of the agricultural or industrial domain of the State, a course which may be adopted on social, as well as economic, grounds. Again, the interest on the debt may be so low, that its redemption may not seem commercially profitable as compared with investment. The objections to state dealings with capital, already noticed,[1] are too serious to be set aside on this ground. The remission of taxation, though it seems to be a sacrifice on the part of the State, may in many cases be the best course. The real source of state revenue is, need we say once more, the national income, and judicious remission of taxation has a beneficial influence on the growth of this reservoir, on which the State in the last resort depends for its tax

[1] Bk. ii. ch. 4, § 1.

receipts. The often-used phrase about allowing taxation 'to fructify in the pockets of the taxpayers' is here exactly applicable. The financial power of the State rests on the economic development of the people, and will be proportional to it. Any special resources in the form of money that may be required are best procured through the agency of bankers. The case in this respect is far clearer, than in the somewhat parallel one of manufacture of weapons and supplies, since the question of quality, or that of effectiveness of competition, does not arise.

§ 4. Whatever be the conclusion as to special and exceptional cases of state reserves, it is at all events plain that the older policy of hoarding as a general rule of finance is obsolete. It is, in fact, on its ruins that the modern phenomenon of public debts has arisen. From keeping a reserve to meet all emergencies States have passed to the opposite course of not paying even their working expenses. The problem of public indebtedness is becoming more and more important, and is giving rise to serious questions. The remaining chapters of the present book will therefore be devoted to an examination of the different aspects of this vital part of modern finance.

CHAPTER II

PUBLIC INDEBTEDNESS, ITS MODERN DEVELOPMENT

§ 1. THE development of public indebtedness accompanied the decline of the older system of treasures. In its present form it is essentially a creation of the last two centuries, and even within the last fifty years it has gained more ground than in all preceding periods. The causes of its rise and immense expansion must be sought in the special circumstances, both political and social, of the time.

There is an appearance of exaggeration in the statement that public borrowing has only come into existence since the end of the seventeenth century. In all but the rudest societies credit has been more or less employed, and we can hardly conceive that the governing body would altogether neglect its use in times of need. So far, however, as classical antiquity is concerned, there is hardly any trace of loans to the State. The explanation of this fact lies in the characteristics of Greek and Roman society.[1] Instead of borrowing from the wealthy citizen, the State adopted the more drastic, but in the long run less fruitful, method of levying a special tax on him. The small amount of floating capital also prevented a ready recourse to loans. Compulsory loans, or the farming-out of taxes, were, in default of a treasure, the favourite methods, to which may be added the rarer one of pledging some state or

[1] *Introduction*, ch. 2, § 1.

regal possessions. Temporary credit transactions with contractors were the nearest approach to a public debt in our use of the term.[1]

§ 2. The Middle Ages show little advance on—in some respects they fall below—the economic position of the Roman Empire. The strong sentiment against usury and the feeling that it was beneath the dignity of a prince to borrow from his subjects[2] both tended to check the use of the royal credit. Where it was exercised the quasi-private nature of the feudal state system comes out clearly. The King borrows on his personal credit, or on his domain, which he even gives in pledge as a security for payment.[3] These loans were usually obtained from the Church, or from foreign bankers. Hallam tells us that 'in 1345, the Bardi at Florence, the greatest company in Italy, became bankrupt, Edward III., owing them, in principal and interest, 900,000 gold florins. Another—the Peruzzi—failed at the same time, being creditors to Edward for 600,000 florins. The King of Sicily owed 100,000 florins to each of these bankers.'[4] Both in England and France these borrowings grew more common as wealth and the cost of government increased. Francis I. obtained various sums through the city of Paris, which kept a list of the creditors and distributed the interest.[5] Appeals to Parliament in connexion with loans occur as early as the reign of Richard II. Forced loans were tried by Edward IV., and by the Tudors in the

[1] Roscher, § 130.

[2] *Turpe est et multum regali reverentiae derogat a suis subditis mutuare pro sumptibus regis vel regni.* Thomas Aquinas (?), *De Regimine Principum*, ii. 8. The approval of state treasures by so many early writers was intended as a condemnation of the alternative method of borrowing.

[3] 'The king was both in theory and practice the financier of the nation . . . . if he had to provide security for a loan he did it upon his own personal credit, by pledging his jewels, or the customs, or occasionally the persons of his friends for the payment.' Stubbs's *Constitutional History*, ii. 558. See the whole section for borrowing in mediæval England.

[4] *Middle Ages*, iii. 340. Loans by the French kings can be traced back to 1287. Vührer, *Histoire de la Dette Publique*, i. 2 sq.

[5] Vührer, i. 16–20.

sixteenth century. The pledging of taxes as security for debt is the last step in the older forms of borrowing.[1]

A more advanced position is found in the loans of the Italian cities, especially Genoa and Venice, which raised money through the agency of banks established for the purpose. The bank of St. George in the latter city was the most important instance in this system. The superior commercial development of Italy contributed to the increase of state, as well as private credit, and more especially to complicated dealings in the farming of state domains and taxes.[2]

The commercial revolution of the fifteenth and sixteenth centuries, which depressed the Italian towns, brought those of the Low Countries into prominence. The system of state-borrowing and of lending to foreign countries was engaged in by the Dutch, who, in consequence of the low rate of interest, were anxious to enlarge the field of investment, and therefore undertook most of the limited international business of the time, such as the carrying trade and public loans. Imitation of Dutch methods of commerce and finance—so powerful an influence on the English policy of the seventeenth and eighteenth centuries—was a principal cause of the creation and advance of the English funded debt, which has in its turn been an example to other States.[3]

§ 3. It is thus plain that neither ancient nor mediæval finance possessed the modern public debt system. The latter, indeed, contained the germs from which our present expedients have been developed, but with so many differences that it is hardly right to place two such distinct groups under a common heading. They are, rather, separate

[1] For a good account of the character and defects of mediæval public credit, see Ehrenberg, *Zeitalter der Fugger*, i. 18–31, 55–63.

[2] On the loans of the city States, see Ehrenberg, i. 38–41.

[3] 'Einen Bürgerstaate, der Republik der Vereinigten Niederlande, ist es unter allen modernen Staaten zuerst gelungen, sich einen wirklichen Staatscredit, und mit dessen Hülfe die Unabhängigkeit als Vorbedingung glänzenden Gedeihens zu schaffen.' Ehrenberg, ii. 321.

species of a comprehensive genus. The increase of public debt in modern times is the result of economical and political conditions of the highest interest and importance. From one point of view, the vast indebtedness of States and smaller governing bodies is due to the transition to 'credit economy.' Money, as a medium of exchange, has been largely superseded by the use of credit instruments. In like manner, great masses of property, or, more correctly, the evidence of its ownership, have become freely transferable. The shares of companies, or their acknowledgments of debt, are very readily dealt in. Railways, banks, and other industrial undertakings by this means increase their business and the value of their property. It would be incomprehensible if the greatest of co-operative organisations—the State—declined to avail itself of a like expedient. In fact, governments,—supreme and subordinate, strong and weak,—have mobilised their credit, and thereby increased their immediate financial power. The mechanism of the Stock Exchange has remedied the weakest point in the earlier state-borrowing—the absence of any way of quickly realising the capital lent.

This connexion of public debts with the money market is, perhaps, most clearly seen in the modern methods of contracting loans. Whatever be the particular form adopted the substance of the operation is the same, and amounts to an investment of capital on the part of the lenders, carried out in nearly every case by the special class of dealers in stocks. To the investor there is no difference between taking up the stocks or bonds of a railway and those of a government. In the cases in which the latter are contracted on account of a particular undertaking, the resemblance is even closer. A loan to an Australian colony for railway construction is indistinguishable from one to a company for fresh capital outlay.

Though the modern money market affords the machinery for continued extensions of state-borrowing, it does not

give the motive power. The amount of loan transactions must, it is plain, depend on the conditions of supply and demand; but, then, this somewhat general formula stands in need of further analysis. The reasons for the expansion of demand are discoverable in the increased public outlay of modern societies. We have often had to notice how both military and civil expenditure are growing, and also that some parts of this outlay are at once uncertain, and productive of durable advantage. War and public works require large immediate expense, and their full benefits are not reaped at the moment. To procure sufficient funds by taxation is both disagreeable and, on the surface at all events, unjust. The financier very naturally takes what he knows to be the most convenient, and probably believes to be the fairest, course in appealing to capitalists for assistance. It is true that all loans have not this plausible ground; they are often due to weak or careless finance, and are simply a mode of staving off the evil day. State credit is, like all modern credit, made up of both good and bad elements, and in its case the latter are often the more powerful.

As the increasing cost of the State gives us the motive for its greater borrowing, so do the development of the capitalist class and its greater influence on government explain the willingness to bring forward the needed supply. The earlier loans were either obtained by force, on the pledge of specific property or taxes, or finally on the honour of the personal ruler. In the constitutional epoch, advances are made to an administration over which the moneyed classes have influence. The close connexion of the English debt with the Revolution of 1688 and the maintenance of the system introduced by it is well known,[1] and at an earlier time the Italian cities and the Dutch provinces were under mercantile influence. It is unquestionable that the development of representative government and

[1] Macaulay, *Hist. of England*, i. 141.

its control of the administration have helped to secure a larger supply of loans than would otherwise be forthcoming. At the same time it is easy to overrate the significance of this fact. The mere existence of constitutional rule does not suffice to create borrowing, nor its absence to stop it, as the French debt of the eighteenth century and that of Russia at present will suffice to prove. A powerful class in the possession of disposable wealth will be in a position to act on the most irresponsible of rulers, and a prudent absolutism will recognise the wisdom of sustaining public credit. Nevertheless, the advance of constitutional government and the increase of indebtedness have been coincident, a circumstance due to the fact that both are products of the present stage of development, and not solely because 'the moneyed interest has captured the machinery of government.'[1] The greater attention to justice that, on the whole, characterises popular government naturally operates on public as on other economical relations.

Nor is there any reason to doubt that on the whole the change is advantageous. A strict observance of public faith, besides its immediate services both to lenders and borrowers, has a further influence in making the general financial administration more regular. When we remember the vital importance to a State of being able to secure assistance through credit at times of pressure, it is evident that anything tending to strengthen the guarantees for punctual payment is and must be for the general good.

In some respects, however, the development of public indebtedness has been accompanied by serious, though it may be hoped only temporary, evils. Where the administration is corrupt, or where the interests of the ruler and his subjects are opposed, there has been both undue use of borrowing, and terms far too favourable have been given to the lenders. The taint of rash speculation and of craft,

[1] Adams, *Public Debts*, 9. So far as the influence of the wealthier classes is directed to securing public credit it is decidedly beneficial.

amounting in some cases to fraud, which hangs round the modern *Bourse* has affected the great class of public loans. It may be that religious or political prepossessions have led some critics to attach too much importance to these dark features,[1] but there can be no doubt of their existence. Immense advances have been made to governments that no prudent person would trust, and for objects that could not possibly be regarded as beneficial. Exorbitant rates of interest, in order to cover the great risk incurred, have been stipulated for, but not always paid; while, finally, the course of public policy has been sometimes influenced by sinister financial interests. Such practices naturally and justly arouse strong feelings of hostility in the minds of the sufferers, and of all whose moral standard is not debased; but in condemning them we should not forget the solid benefits that public credit has conferred on the world, nor the extent to which evil and good are usually blended in the ordinary economic transactions of men. There is, too, decided evidence of improvement. International public opinion is better pronounced, and, as in the case of individual credit, the sphere of the usurer in national transactions is being gradually restricted.

§ 4. The powerful effect of the influences that favour indebtedness is shown by the figures of every stock exchange, and by familiar facts of statistics. Out of the, in round numbers, 1,800 stocks quoted on the London market, 340 may be fairly described as public, of which the larger part are British. Berlin has something over half that number, of which about one-third are German.[2] Paris has a still

[1] The Socialists and some Catholic writers are very vehement in their attacks on *La Haute Finance*. For more moderate criticism see C. Jannet, *Le Capital, La Speculation et La Finance*, ch. 12. He, however, shows (ch. 11) that at the commencement of the modern loan system the evils were greater. The student of the history of the money market feels the truth of Emerson's remark, that 'the first lesson of history is the good of evil.'

[2] Cohn, §§ 535, 536. "At the present time over one hundred States that

larger number. We may say that any State that pretends to be civilised regards the creation of a debt as one of the essential marks of its having reached that position. So does every colony and large city. The latest developments of municipal life are shown in the issue of bonds by the responsible authorities. Universality is one of the features of the modern debt system, and it is explicable only by reference to the conditions noticed in the preceding section, together with, in the case of backward States, the influence of imitation.

Public indebtedness is remarkable, not merely for its universal employment, but also for its great and growing amount. The following details are instructive, though in most cases the results are only approximate. The total public debts of the world in 1783 have been estimated at £506,000,000; by 1820 they had increased to £1,530,000,000; their amount in 1848 was about £1,730,000,000. According to a careful estimate, the national debts of European States in 1870 were, in round figures, £3,000,000,000, in 1885 they had risen to £4,600,000,000, or an increase of £1,600,000,000 in fifteen years.[1] In 1900 the debts of the Great European powers and the United States were £4,000,000,000; Mr. Palgrave states [2] the total debts of the various countries of the world towards the close of 1890 as £6,505,000,000, or an increase of over £1,000,000,000 on the debt existing in 1882. At the close of the nineteenth century the national debts of the world can hardly have been less than £7,000,000,000. This enormous sum does not include the local debts that

possess practical sovereignty for debt purposes offer their bonds to the choice of an English investor, and if to this number were added the obligations of *quasi*-sovereignties, the London Market would show over 150 sorts of public securities. There are here found the bonds of China, Japan, Persia, Siam, Egypt, Liberia, Orange Free State, Zanzibar, besides many other peoples of the Old World. The South American States are nearly all represented.' Adams, *Public Debts*, 5.

[1] Neymarck, *Les Dettes Publiques*, 86.

[2] *Dict. of Pol. Econ.* art. on 'Debts, Public,' i. 509. The estimate given in the United States Census Report for 1890 is somewhat lower.

are, if we may judge from all available facts, increasing even more rapidly. Both have been growing apace in such a manner as to excite the apprehension of reflecting observers. The reality and extent of the danger will demand examination later on—the existence of the circumstances that have caused alarm is all that concerns us at present; but even at this stage of the inquiry, it is well to notice the fundamental difference between two classes of debt, the one contracted for non-economic ends, the other for purposes of reproductive employment. War and public works have been mentioned as the two chief causes of abnormal outlay, and loans for these objects belong respectively to the different classes. To take obvious instances, the great addition to the French debt from the war of 1870-71 cannot be regarded in the same light as the indebtedness of Prussia and other German States for railway purchase and construction. The former involves increased taxation; the latter, if prudently applied, does not. The same contrast appears in the case of the English national, as opposed to the local debt, though this instance suggests the necessity of a qualification. Outlay on public works is not of itself, and apart from the revenue to be thence derived, different from the cost of war, or other unproductive expenditure. No readier or more dangerous mode of increasing debt can be found than the execution of works that are not economically productive. Vague assertions of indirect benefits should not be allowed to conceal the fact that 'improvements' of this kind should be paid out of income, and cannot be regarded as investments in the proper sense of the term.

§ 5. To summarise the results of the present chapter: state borrowing appears to be, in its leading features, a creation of the constitutional period, built upon the decay of the older method of state hoarding and having its germs in the Middle Ages. It is the result of the credit system, combined with the increase of public expenses and the greater security for observance of faith to the state

creditors. Both on account of its universal employment and its rapid growth, it is one of the most influential factors in modern finance, and one whose tendencies and actual effects are deserving of close attention. To form a just appreciation of the system, a study of its history in the more important countries is desirable; and we shall therefore devote some space to this side of the question before passing to its theoretical aspects.

CHAPTER III

THE HISTORY OF THE ENGLISH DEBT

§ 1. THE longest and in many respects the most instructive history of a continuous national debt is that supplied by Great Britain. The earlier attempts at systematic borrowing in Italy and Holland have ceased to have any practical effect, but the present English debt shows an unbroken record of more than 200 years. The Stuarts had not paid much respect to their obligations, and were quite prepared to repudiate inconvenient liabilities. Still, the expansion of the public economy made it impossible to avoid some floating charges. At the completion of the Revolution in 1689 the debt stood at a little over one million (£1,054,925); in 1691 it had risen to £3,130,000, bearing an interest charge of £232,000. An Act was passed in the next year which is regarded by Macaulay as the origin of the National Debt, and which provided that £1,000,000 should be borrowed on the security of the beer and other liquor duties. The yield of these taxes was to form a fund for the payment of interest, with the proviso that as each subscriber died his annuity was to be divided among the survivors until their number was reduced to seven, when as each annuitant died his share would lapse to the State.[1] The necessities of the war with France compelled further borrowing. The funded debt is first mentioned in 1694. In that year the

[1] Macaulay, *Hist. of England*, ii 398.

Bank of England was founded, and lent its subscribed capital, £1,200,000, to the Government at the rate of 8 per cent., which, with an allowance of £4,000 for management, made a total charge of £100,000 per annum. The connexion thus formed between the Bank and the Whig party continued as an influence in politics for several years.[1]

At the Peace of Ryswick (1697) the debt had reached £21,500,000, but in the four succeeding years of peace it was reduced to £16,400,000. The East India Company had lent £2,000,000 at 8 per cent. in 1698, which sum was applied to paying other obligations. There was thus a reduction of about £1,250,000 per annum during peace, as against the increase of £2,500,000 per annum during the longer war period, a state of things that we shall find repeated at several subsequent stages of the history. During the war of the Spanish Succession the debt rose at the rate of over £3,000,000 yearly, until at the Peace of Utrecht (1713) it came to £53,680,000.[2]

During the peace period, which, with a couple of slight exceptions, extended from 1713 to 1739, the movement of the debt was not uniform. In the first ten years owing to the South Sea Bubble, the war with Spain, and the method of dealing with taxation, it increased to £55,200,000. Then during the remaining sixteen years of peace, under the prudent administration of Walpole, some reduction was made, so that in 1740 the amount was just under £47,000,000, or an annual diminution of £500,000.

[1] Macaulay, *Hist.* ii. 479; Rogers, *First Nine Years of the Bank of England*, xiii. xiv.

[2] One curious item, the oldest of all, and hence sometimes regarded as the origin of the debt, was added in 1706. The Cabal Government of Charles II. had in 1672 seized on the Goldsmiths' loans to the Exchequer, a proceeding known as the 'shutting of the Exchequer,' and had simply paid interest on the amount of £1,328,000 detained. In 1683 even the interest was stopped. Legal proceedings were taken by the sufferers, and after a series of trials the House of Lords decided in their favour; but by an Act of 1699 it was provided that after December 25th, 1705, one-half the amount (£664,000) should be added to the existing debt, to bear interest at 6 per cent.

§ 2. This first half-century of the debt's existence presents several points of financial interest. The effect of war in adding to debt, to be a little reduced during the succeeding peace, has been noticed. A more important feature is the gradual introduction of funded debt. Annuities, tontines, anticipations of taxes, and floating or temporary liabilities tend to be absorbed in the now established form of capital advances for interest. The various separate debt accounts become blended in one indistinguishable charge. 'The *Aggregate Fund* was established in 1715 and the *South Sea* and general *Funds* in the following year. To each of these funds a variety of branches of revenue were appropriated . . . and each of them was charged with the payment of certain annuities then due by the public. The united surplus of these funds formed the basis of the sinking fund established in 1716.'[1] This is the first appearance of the system which, at a later time and in a different form, was regarded as the most effective agency for reducing debt. The primitive sinking fund, usually called 'Walpole's,' was really due to Stanhope. It proved of little service for the purpose to which it was applied, as it depended on the existence of a surplus whether debt would be redeemed, and the contraction of new liabilities would always render nugatory the payments made towards redemption.

The first instances of the process know as 'conversion' also occur in this period. In 1714 the legal rate of interest had been reduced from 6 per cent. to 5 per cent., and three years later a like reduction was made on the interest of the public debt. Again in 1727 a further reduction from 5 per cent. to 4 per cent. was made, by which a saving of £400,000 per annum was realised. The good effect of Walpole's financial management was proved by the high price that the funds had reached. A 3 per cent. loan issued in 1727 stood at *par* in 1736, and in the next year at 107. Under such conditions it is plain that the whole redeemable debt might have been reduced to 3 per cent. or even lower.

[1] Hamilton, 64.

Political expediency, which made it an object to favour the fundholders, who were strong supporters of the Hanoverian dynasty, prevented this useful measure.

§ 3. The war of 1739–48 had the usual effect of increasing indebtedness. After the conclusion of peace it was found that £31,300,000 had been added to the previous incumbrances, bringing the total amount to over £78,000,000. The return of peace gave an opening for the application of financial management. Pelham in 1749 succeeded in carrying a conversion scheme, which may be regarded as the forerunner of the modern arrangements of the kind. Interest on part of the debt was reduced to 3½ per cent. for seven years, and 3 per cent. afterwards. Next year that on the remainder was reduced to 3½ per cent. for five years, and 3 per cent. afterwards. The fundholders at first dissented, but the high price of stock made it their advantage to accept the conditions. The consolidated 3 per cent. stock was established in 1751, and existed till the conversion of 1888 as the principal part of the debt. Its price in 1752 was 106¾, the highest point it ever reached. The sluggish condition of trade, and the difficulty of finding good investments sufficiently explain the existence of so high a price.

Up to 1756 the debt had been reduced about £6,000,000 and stood at £72,200,000 when the Seven Years' War commenced. Expenditure at once rose so much as to lead to borrowing, which continued until, at the close of the war in 1763, the funded debt was £122,600,000 with a floating debt of about £14,000,000. The consequences of the war were apparent in the position of the Exchequer for some years afterwards. In 1766 the funded debt had risen to £129,500,000 with a further unfunded one of over £10,000,000. The succeeding years of peace allowed of small reductions, coming in all to about £10,000,000 in 1775, when the funded debt was £125,000,000 and the floating one £4,150,000, or a total of almost £130,000,000. As might be expected, the American war of Independence added seriously to this burden. At the conclusion of

the Peace of Versailles (1783) the total debt was over £238,000,000 or an annual increase of about £13,500,000. During the latter part of the war the strain on English credit was shown by the low price obtained for the loans of that period.

Pitt's first administration dates from 1783, and its earlier part, which may be called the peace one, and which ended with the outbreak of the war with France, did not accomplish much in the direction of diminishing the capital of the debt. In 1786 the new Sinking Fund was established, and by 1793 it had redeemed about £10,250,000, leaving a net capital charge of £228,000,000.

The characteristics of the second half century of the debt history are found in the great growth of both capital amount and interest charge. After taking into account the small repayments in time of peace, there remained a net addition of £180,000,000 in the fifty-four years 1739–1792, while the annual payment for interest had risen from £2,000,000 to nearly £9,500,000 in the same period. The terms of borrowing varied, but up to 1780 the loans were usually issued at par: their capital therefore represented the amount really received, though they were accompanied by small annuities for terms of years, or other special favours. Lotteries were also combined with the loans, subscribers to an issue of stock receiving tickets. In 1781, however, a loan of £12,000,000 was raised at the rate of £150 of 3 per cent. and £25 of 4 per cent. stock for £100 paid, or a total capital of £21,000,000. The result of adopting this system was to add nearly £25,000,000 to the nominal capital of the debt without any corresponding receipt. It was probably due to the fear entertained by subscribers that their stock would on the return of better times undergo a reduction of interest, and also to the preference of the government for a large 3 per cent. stock. As mentioned above, the sinking-fund policy which so powerfully affected the course of the debt was started at this time, though its influence was not as yet very noticeable.

§ 4. By far the most important and critical period in the development of the debt is that during the protracted struggle with France, first under the Revolutionary government and afterwards under Napoleon I. Without the abnormal expenditure of the twenty-three years 1793–1815, the sinking fund of 1786 would have automatically wiped out the comparatively small capital liability; and the rapid growth of British industry, free as it would have been from the oppressive taxation that Pitt was compelled to impose, would have made the operation practically unfelt. The whole financial system of Great Britain has been profoundly affected, but the present debt is the most prominent of these results.

From the outbreak of war (1793) to the peace of Amiens (1802) loans were required in every financial year. The amounts, at first small, rose with the great outlay that the continuance of hostilities made necessary, till in 1797 the capital funded was over £67,000,000, the actual sum obtained for this acknowledgment of debt being £44,000,000. As nearly £7,000,000 were redeemed by the sinking fund, in that year, the net increase of debt was somewhat over £60,000,000. In the other years the additional debt contracted was not nearly so large,[1] but the effect of the methods pursued was shown in the amount of debt at the conclusion of peace. It was just £500,000,000, an increase of over £270,000,000 since the opening of war in 1793, *i.e.* £27,000,000 per annum. The sinking fund had besides

[1] The following was the capital funded for each year between 1793–1802 :—

Year.	£
1793 ...	6,250,000
1794 ...	15,676,526
1795 ...	25,609,898
1796 ...	41,303,699
1797 ...	67,087,669
1798 ...	30,000,000
1799 ...	27,499,250
1800 ...	29,045,000
1801 ...	44,816,250
1802 ...	41,489,438

See Hamilton, 256.

paid off £57,000,000 of the debt incurred, which must be added to the other liabilities of the time. The principal cause of this great addition was the unwillingness to impose taxes at the commencement of the war. For the four years 1793–7 the total amount raised in taxation was £70,000,000, or £17,500,000 on the yearly average, while for the four years 1799–1802 it was £134,750,000, or an increase of 92½ per cent.

The short peace did not allow of any reductions in expense, and on the recommencement of war the borrowing system was again applied, though not to so large an extent. At the opening of the year 1816 the funded debt was £816,000,000, with a floating one of £60,000,000, showing a total increase of £360,000,000, or over £25,000,000 per annum. This comparatively satisfactory result, notwithstanding the immense expenditure of the Peninsular War, is explicable by reference to the much heavier taxation imposed. The income tax was in full operation, and the tax revenue rose from £37,250,000 in 1803 to £75,500,000 in 1815. Mr. Gladstone has asserted that the early adoption of the income tax would have saved the necessity of borrowing, since the annual expenditure apart from the debt charge would in the later years have been met by the receipts from taxation.[1] Whether this would have been possible may be a matter of dispute, but there can be no question that the system of loans was carried to excess.

From the facts just noticed we can see clearly the defects in the method of finance during this trying period. They are: (1) the dislike to impose sufficient taxation, a feeling very natural on political grounds, but indefensible from the purely financial point of view. Instances of this error occur chiefly in the earlier years. (2) An undue reliance on the purely illusory expedient of a sinking fund, which, taking the most favourable view, increased the expense of management and deranged the loan market. (3) The system of

[1] *Financial Statements*, 16.

borrowing at a higher nominal capital than the amount actually received, thereby preventing, or at least hindering, future conversions of debt.

§ 5. The French wars brought the English debt to its maximum point. Since that date there has been some, though insufficient reduction of it. The whole course of treatment has tended towards the adoption of a sounder and more careful policy, guided in a great degree by the influence of theory. The criticisms of Hamilton and Ricardo[1] exposed completely the sinking-fund fallacy. As the result of careful inquiry it was settled, in 1819, that a real surplus of £5,000,000 annually should be preserved; but after various difficulties and changes, the sinking-fund as a positive institution was abolished in 1829, whatever actual surplus existed at the end of each financial year being marked off for redemption of debt. The continuance of peace enabled the method of conversion to be tried with effect, though the field of operations was limited by the mistaken policy of borrowing in a 3 per cent. stock with a high nominal capital. In 1822 £152,000,000 of 5 per cent. stock was converted into 4 per cents., and in 1830 further reduced to 3½ per cents. The old 5 per cent. stock (76,250,000) was reduced to 3½ per cent., to which rate a small balance of 4 per cents. (about £10,000,000) was also reduced in 1834.

One of the most discreditable periods in English finance was that between 1830 and 1840. Hardly any fiscal reforms were carried out, and the debt was increased by budget deficits. Its amount in 1841 was £792,000,000, nearly £8,000,000 more than in 1830. The firmer administration of Peel restored the finances. A surplus was procured by the revived income tax, and a fall in the rate of interest made it possible in 1844 to convert the 3½ per cent. stock—£248,000,000—into 3¼ per cent. for ten years and

[1] Hamilton's *Inquiry* was published in 1813, and Ricardo's *Essay on the Funding System* in 1820.

3 per cent. afterwards. The attempt made by Gladstone, in 1853, to create a 2½ per cent. stock, proved a failure, owing to the rise in interest and the pressure of the Crimean War (1854–5). This latter event supplied further illustration of the operation of war on indebtedness; though the progress of wiser views as to the treatment of extraordinary expenditure was evidenced by the increased taxation, which contributed the larger part of the total war expenditure (£70,000,000), leaving only £34,000,000 to be added to the debt.

§ 6. For nearly half-a-century (1856–1899) no important increase in debt took place, and the growth of wealth made the weight of the existing charge much less oppressive. Moreover though there was no energetic action for the repayment of the debt, the influence of the reformed sinking-fund, the terminable annuities, and conversion produced a decided effect on both capital and interest: in fact during this period the history of the debt consists in an account of their operation.

When the sinking-fund theory was abandoned, the old rule still applied by which the surplus remaining in the Exchequer at the end of each financial year passed to the Commissioners for the redemption of the debt. If large surpluses were realised year after year, this would be a satisfactory method, but with accurate balancing of receipts and expenses it is of little service. A considerable excess of receipts over expenditure gives rise to a cry for remission of taxation that is not easily withstood. Hence the need for marking off some special funds for the payment of debt Sir S. Northcote's sinking-fund measure (1875), by which an amount of £28,000,000 annually was permanently set apart for this end, is the most obvious course. Unfortunately it is very easy to find plausible reasons for cutting down the sum so fixed. Under Lord Goschen the £28,000,000 became first £26,000,000 and then only £25,000,000, a sum which left a comparatively small

margin over the interest and terminable annuity payments but which was again reduced by Sir M. Hicks-Beach in 1899 to £23,000,000.[1]

The method of redeeming debt by the use of terminable annuities was on the whole more effective. In their commencement public debts were often raised by annuities in various forms,[2] and during the Revolutionary and Napoleonic wars the system of adding long annuities to the funded loans was adopted, the periods being so arranged as to all terminate in 1860. By this system a considerable relief was gained when the date of expiry was reached. As an effective method of redemption fresh terminable annuities have been created, and an equivalent amount of stock cancelled. The largest creations were in 1868 and 1884. In the former year £24,000,000 of savings-bank stock was cancelled, and an annuity of £1,760,000 substituted. In 1884 Chancery stock to the amount of £40,000,000, and over £30,000,000 of Post Office savings bank stock, were similarly treated, with the result that the funded debt was brought within more moderate limits. In 1860–1 its total amount was £788,970,799. After thirty years it stood in 1890–1 at £579,472,082, or almost £210,000,000 less. On the other hand, the terminable annuities had risen in capital value from £16,500,000 to £68,500,000, an increase of £52,000,000. In 1889 the funded debt had risen to £583,186,305, owing to a reduction of floating charges, while the terminable annuities were reduced to a capital value of £36,250,000.

Within the last fifteen years the agency of conversion has also been employed with success. Mr. Childers's conversion scheme of 1884, by which $2\frac{1}{2}$ or $2\frac{3}{4}$ per cent. stock might, at the option of the holder, be obtained for the existing 3 per cents., with an increased capital of 2 or 8

[1] By the budget of 1894 an aggregate sum of £2,123,000 was placed on the reduced sinking fund, thus lowering still more the amount devoted in that year to the redemption of debt.

[2] See § 1, and ch. 6, § 2, of present Book.

per cent., according to the stock chosen, failed to attract. Only £21,648,000 of stock was offered for conversion (more than half of it from public offices). But the failure of this attempt prepared the way for Lord Goschen's success in 1888. The principles adopted by him were: (1) the creation of a single new stock, so that holders were not confused by having to choose; (2) the avoidance of any addition to capital; (3) the use of the most effective technical methods, such as conversion without expressed consent, where this course was legal, commission to agents for the trouble imposed on them, and a small concession in the substitution of quarterly for half-yearly payments of interest. These contrivances, together with the persistent low rate of interest, enabled the conversion to be carried out with complete success. The whole mass of 3 per cent. stock, amounting to £558,000,000, was converted, or paid off.[1] A new stock, bearing interest at 2¾ till 1903, and at 2½ from that date for twenty years, has taken the place of the older 3 per cents., and a relief in interest to the amount of £1,400,000 annually has been secured, with the certainty of an equal gain in 1903. As an incident of the process the floating debt became larger, and amounted in 1891 to £36,000,000 or more than double the normal level. But by degrees the greater part of this sum was funded, so that in April, 1899, the floating debt was only £8,133,000.

§ 7. A new chapter in the history of the debt began with the outbreak of the South African War in October 1899. It was at first believed that the cost would be small—£10,000,000 being the earliest estimate—and the only provision made was an issue of £8,000,000 in Ex-

[1] The total was composed as follows:—

	£
Consols	323,000,000
Reduced Threes ...	69,000,000
New Threes	166,000,000

About £58,000,000 was held by government departments, leaving £500,000,000 in the hands of the public.

The amount for which payment was demanded was very small; in the case of the 'new threes,' only £761,000, or less than ½ per cent.

chequer Bills. By the close of the financial year 1899–1900 the real character of the contest was better understood, and a war loan for £30,000,000 was issued with an appeal to patriotic sentiment, to run for ten years, bearing 3 per cent. interest at the price of £98 10*s.*, or 1½ per cent. discount. Further issues, in the form of Exchequer Bonds, with 3 per cent. interest, and redeemable, some in 1903, and the remainder in 1905, followed. These represented a capital debt charge of £24,000,000. In 1901 it was evident that the expedient of creating unfunded debt had been carried to its utmost limit, and accordingly one of the features of the budget proposals of that year was the issue of £60,000,000 of the ordinary Consols at the price of £94 10*s.* or a discount of 5½ per cent. As the war continued during the first months of 1902, another loan in Consols to the amount of £32,000,000 was arranged at the fixed price of £93 10*s.*, giving a discount of £2,080,000 on the whole amount.[1] Even the conclusion of peace did not relieve the country from the necessity of contracting this fresh liability, though it was hoped that a part of the funds obtained by it might be available for the repayment of debt. During the years 1899–1902 there was also a suspension of the operations for the redemption of the debt which provided a further resource of between four and five millions a year. The net result has been a decided increase in all the different forms of indebtedness. The floating debt has somewhat increased;

[1] The following are the details of the different loans:—
National War Loan £30,000,000, 2¾ per cent. interest, redeemable April 5th, 1910, issued at £98 10*s.* 0*d.*
Exchequer Bonds, £10,000,000, 3 per cent. interest, redeemable August 7th, 1903, issued at £98.
Exchequer Bonds, £3,000,000, 3 per cent. interest, redeemable December 7th, 1905, issued at £98 2*s.* 11*d.*
Exchequer Bonds, £11,000,000, 3 per cent. interest, redeemable December 7th, 1905, issued at £97 5*s.* 4*d.*
Consols, £60,000,000, issued at £94 10*s.*
,, £32,000,000, ,, ,, £93 10*s.*
Treasury Bills in various amounts. Total for War purposes, £13,000,000.

the Exchequer Bonds and the £30,000,000 war loan represent short term loans of a class better known in American than in English finance. The terminable annuities have been raised to £60,000,000 by the provisions of the Budget of 1899.[1] But the funded debt, though relieved by the adjustment just mentioned, has had two large issues of Consols added to it. In short, the total charge on March 31st, 1902, was £747,876,000, an increase of £60,000,000 over the total of the preceding year.

The preceding details afford certain obvious points for criticism. First, there is the large proportion of the war expenses supplied by borrowing. Some difficulty exists as to the exact figures, but it is well within the mark to say that more than two-thirds of the extraordinary outlay has been met out of loans, a position that compares unfavourably with the similar case of the Crimean War. Next, there is the curious policy of issuing loans at a fixed discount, instead of inviting tenders, or so arranging the interest that the par value should be obtained. Finally, there is the question whether all the issues should not have been in the form of a single uniform stock, which would command a better price, and if issued at 3 per cent. would in a short time be ready for conversion. But the most interesting question is one of the immediate future, viz. the method and extent of the proceedings for redemption. A good deal of stock will be ready for treatment in the years 1905 and 1910. Much, however, must depend on the market price of Consols, and therefore the agencies of redemption will have to be kept in an elastic form. In any case there has been a clear illustration of the way in which two or three years of war will undo the work of eighteen or twenty years of peace.[2]

[1] This operation consisted in the cancelling of £28,000,000 of Consols and the substitution of two annuities arranged to expire in 1923.

[2] The figure of £747,876,000, given above as the debt burden in 1902, is slightly higher than that of 1884, which was £746,424,000. The inclusion of the latest loan of £32,000,000 would bring us back to 1873 with its total of £779,222,000.

§ 8. Looking back on the course of the English debt, it is very plain that its growth has been altogether due to war expenditure, while its continued existence must be largely attributed to financial weakness. A comparison of the debt incurred during each war with the amount paid off in each succeeding peace establishes this. Over £600,000,000 was added in the great war (1793–1815); hardly £75,000,000 was paid off in the forty years' peace. The Crimean War added £34,000,000; it took twelve years of peace to pay off this sum. The South African War has increased the capital of the debt by £160,000,000. It is safe to say that twenty years of unbroken peace will hardly suffice to remove this extra burden. Greater vigour in the use of terminable annuities, the maintenance of larger surpluses, and above all a wider employment of direct taxation in the form of income, property, and inheritance taxes are the means by which better results might be obtained. The pressure of the debt, however calculated, is too light to justify such remissness. When we remember that each million of debt redeemed means the power of permanently remitting as much taxation as is represented by its interest charge we can better understand the advantage of an energetic policy in regard to it.

CHAPTER IV

HISTORY OF THE FRENCH DEBT, INDEBTEDNESS IN OTHER COUNTRIES

§ 1. A NATURAL division of the history of the French debt is that into two parts; the former dealing with the borrowing under the Monarchy, and the latter with that under the system founded during the Revolution. The history of the various loans previous to the present century has been concisely described as 'a history of bankruptcies.'[1] All forms of loans were tried; and all possible methods of evasion were used to escape repayment. The costly wars and the internal disturbances of the country partly explain this course of policy, but ignorance of financial and economic conditions was the great cause. Forced reductions of debt and debasements of the currency were frequently employed. An extensive revision was carried out by Sully in 1604, and further reductions were made by Mazarin. Colbert's administration introduced some system into this part of finance, but after his death the older confusion reappeared. One of the effects of the Mississippi scheme was a consolidation of the diverse forms of the debt, and a reduction of its amount to a sum, estimated at 1,700,000,000 livres, with an annual charge of 48,000,000 livres.[2]

[1] Vührer, i. 320. Cp. Ehrenberg's account of Spanish finance in the 16th century. 'Es trieb rettungslos aus einer Krisis in die andere. Staatsbankerott und Zwangsconsolidation wurden gewöhnliche Finanzmittel,' *Zeitalter der Fugger*, ii. 259.

[2] *Ib.* i. 181. The estimates, however, are not in agreement. *Ib.* i. 178.

The reign of Louis XV. (1715–1774) was marked by fresh loans and repeated forced reductions of the capital debt. In 1764 the sum of the different liabilities was 2,360,000,000 livres and the annual charge 93,000,000 livres; at his death the total annual charge was 120,000,000 livres, besides a floating debt of 235,000,000 livres. The increasing embarrassments of the State, which might have been overcome by Turgot, had he remained in office, were at least the proximate cause of the summoning of the States-General, and therefore of the Revolution.[1] According to the report submitted by the committee of the Constituent Assembly in November, 1789, the annual debt charge came to 208,000,000 livres, to which the floating debt had to be added.[2]

§ 2. The financial difficulties that surrounded the revolutionary governments led to large issues of *assignats*, and to a consolidation of the public debt on a plan arranged by Cambon (August, 1793). By it all debt was to be inscribed in a 'Grand-book,' which was to be the conclusive evidence of the claim. The redeemable debt with 5 per cent. interest was first so treated, and the annuities were afterwards added. The result was the creation of an annual charge of £7,000,000 (174,716,000 francs), or a capital debt of £140,000,000. Unfortunately, the use of paper money and forced loans destroyed whatever benefit this systematic treatment might have conferred, and the straits of the government led to the measure of 1797 (*Vendémiaire, Ann* vi.), by which two-thirds of the debt was 'paid off' (?) in bonds to be exchanged for land, and, after some reductions for confiscations, the balance in annual interest was ascertained to be £1,600,000 (40,216,000 francs), representing a capital debt of £32,000,000. About £250,000 was added to the interest charge by the Directory, so that by the

[1] Necker's policy of meeting deficits by borrowing, in opposition to that of Turgot's, is justly condemned by Gomel, *Causes Financières de la Révolution Française*, i. ch. 8.

[2] Vührer, i, 336. But see for a higher estimate, Gomel, i. 487–9.

opening of 1800, 46,300,000 francs was the annual payment. The financial administration of Napoleon I., or rather of his advisers in such matters, Gaudin and Mollien, had two great merits. It resisted all temptations to issue inconvertible paper money, and it steadily refused to meet war expenditure by the method of borrowing. The result is to be seen in the position of the public debt at the fall of the Empire. In April, 1814, the interest had risen to 63,300,000 francs (£2,530,000). After allowing for the debts of the annexed provinces, the net increase was less than £300,000 interest, or £6,000,000 capital. In qualification of this favourable situation the immense burdens imposed on France and other countries must be taken into account. The Napoleonic system of making war support itself was a crushing one for the nations subjected to its operation, and probably far heavier than a well-managed public debt would have been.[1]

The Government of the Restoration had a series of difficult financial tasks to face. It had to meet the war indemnity levied on France by the allies; it had to compensate the emigrants; and it had to take up the unpaid balance of the Imperial outlay. It handled these various problems with honesty and firmness, refusing altogether to repudiate the debts of the Empire, as some of its supporters wished. The principal feature of debt history during the period 1815–1830 is the creation of new debts to meet the indemnities and other outlay. The total amount required for these purposes represented an annual charge of over £6,500,000.[2] A second noticeable point was the creation of other than 5 per cent. stock. The emigrants' indemnity was in 3 per cent. stock, and the conversion of 1824 was partly in 4½ per cents. and partly in 3 per cents. At the same time the policy of redemption was effectively carried on. The annual charge was reduced by 54,000,000 francs (£2,160,000), and conversion removed about 6,000,000

[1] On the debt system of the First Empire, see Vührer, ii. 31–58.

[2] Vührer, ii. 160.

francs. These sums, with a few small escheats to the State, practically wiped out the debt existing in 1814, leaving that created by the Restoration Government (though it was not responsible for it) as the actual charge. From another point of view it may be said that in the fifteen years there was a net increase of £4,000,000 interest. The capital of the new loans amounted to nearly £132,000,000, less the sum of £43,000,000 redeemed, or a net capital increase of about £90,000,000.

The Orleanist Government commenced its career by borrowing. Its first loan added £280,000 to the interest charge, and was issued in 5 per cent. stock at 84, or nearly 6 per cent. on the actual sum received. Another loan of £4,000,000 at par only brought in £800,000. Further loans were made, in order to clear off deficits, to prepare for war, and to carry out public works, but the redemption of existing debt was also carried on, so that against £1,500,000 fresh interest created, about £1,000,000 was redeemed, leaving a net increase of £500,000 during eighteen years, but, it should be said, years of profound peace during which public credit stood high.[1] The position of the stocks over 3 per cent. would have easily admitted of conversion, without any increase of capital, into a 4 per cent. or even 3½ per cent. stock, but to avoid popular hostility this financially prudent course was not taken.[2]

Short as was the duration of the Second Republic, it added £2,120,000 to the interest of the debt, and thus brought the total charge to nearly £9,200,000. The complete disorganisation of the financial system and the hazardous experiments of the provisional government sufficiently account for this state of things.

[1] In 1845 the highest and lowest prices of the several stocks were:

	Highest.	*Lowest.*
5 per cents.	122·85	116·45
4½ ,,	116·25	111
4 ,,	110·5	106
3 ,,	86·4	80·85

[2] Leroy-Beaulieu, ii. 498. [3] Vührer, ii. 238.

The first financial performance of the Second Empire was the conversion of the 5 per cent. stock, amounting to £140,000,000, into 4½ per cent., with a gain to the State of £700,000 per annum. Less than £3,000,000 of capital had to be paid to dissenting creditors. But the management of the war expenditure was not so satisfactory. The total cost of the Crimean War to France was £66,000,000 and of this sum £61,500,000, or 93 per cent. of the whole, was added to the debt. Further loans, issued much under par, followed for the Italian and Mexican wars. The total addition to the debt between 1852 and July 1870 was represented by an increased interest charge of £5,160,000. Thus the annual payment had risen to £14,400,000, and the capital was a little less than £480,000,000. Even more questionable than the large borrowing was the conversion of 1862, by which, for the sake of a premium, the 4½ and 4 per cent. stocks were converted into 3 per cents., with a proportionally increased nominal capital. This unjustifiable measure gained a premium of £6,300,000 for the State, but on the other hand it increased the capital of the debt by almost £64,000,000, and precluded the hope of further speedy conversion.[1]

§ 3. The Franco-German War of 1870–1 is as marked a period in the development of the French debt as the war with Napoleon I. was in the case of the English one. Its first effect was to place an enormous strain on the resources of the new government. In addition to the terrible expense and sacrifice due to the military operations there was the indemnity of £200,000,000 to the Germans. The total burden imposed on the State has been estimated at £393,000,000. Of that sum about £340,000,000 was raised through loans of one kind or other. Nearly £60,000,000 was received from the Bank of France by the inconvertible paper issues. Over £40,000,000 was borrowed in 1870, and two great loans, the first of

[1] For the finance of the Second Empire, see Vührer, ii. 258–369.

£80,000,000, the second of £120,000,000, were raised in 1871 and 1872.[1]

The debt incurred to the Bank of France was cleared off by annual payments, at first of £8,000,000, and afterwards of £6,000,000, until in 1879 the whole was discharged. In other respects the treatment of the debt has been weaker. Fresh loans have been contracted for public works, and to meet budget deficits. M. Freycinet's plans accounted for a large part of this increase in debt, which was raised in 3 per cent. stock terminable after seventy-five years. Thus a new category of debt was added to the old perpetual *rentes*, with a nominal capital of £160,000,000, an interest charge of £4,800,000, and a further charge of £1,000,000 for redemption. The old 5 per cents. were converted in 1883 into 4½ per cents. without any increase of capital, and merely with the proviso that no further reduction would be attempted for ten years. In 1894 the expiration of this term and the high price of the stock allowed of a fresh conversion into 3½ per cents. which was successfully completed. Out of a total capital of £271,500,000, only £55,750 was demanded by the holders, the remainder being retained at the lower interest. In this way the State gained over £2,700,000 annually. A further step in the treatment of this stock has been made in 1902 by M. Rouvier's measure for its reduction to 3 per cent., accompanied by a bonus of 1 per cent. to those who accept the conversion, and a guarantee against redemption for eight years. Besides the

[1] The loans contracted were as follows:

Date.	Amount received. Millions of francs.	Nominal capital created. Millions of francs.	Amount of interest. Millions of francs.
August, 1870	804	1,327	39·8
October, 1870	208	250	15
June, 1871	2,293	2,779	139
July, 1872	3,498	4,140	207
Total	6,803	8,496	400·8

Cp. Vührer, ii. 538; Leroy-Beaulieu, ii. 573. For a full treatment of the finance of the early years of the Third Republic, see Léon Say, *Les Finances de la France*, vols. i. and ii. His account is first hand evidence.

reduction in interest there is the additional advantage of consolidating the stock with the larger mass of existing 3 per cents.

Notwithstanding these important economies, both the annual charge and the capital account of the French debt are extremely heavy. The consolidated debt amounts to £880,000,000, with annual interest of nearly £28,000,000. When the other liabilities are added we get the enormous total of £1,300,000,000, involving an annual cost of £50,000,000, of which about £3,500,000 is applied to its redemption.[1]

The French debt is by far the largest in the world, being double the English in annual charge, and over £500,000,000 greater in capital amount. This great accumulation of debt has been altogether the work of the present century. A comparison with the English debt will show the steps by which the latter has been approached and then passed. It is also interesting to note the widening distribution of *rentes* among the French population. In 1830 the holdings of stock were only 125,000 in number. By 1869 they had increased tenfold, while in 1881 they numbered more than 4,000,000. The great mass of the debt is in the hands of Frenchmen, and divided among all classes of society. This, though in some respects desirable, hampers a finance minister in such processes as conversion or repayment, as the fundholders' interest is at once

[1] The constitution of the French debt on January, 1st, 1901, was as follows :

	Interest. Million francs.	Capital. Million francs.
Perpetual *Rentes* 3½ per cent.	237·6	6,789
,, ,, 3 ,,	456	15,211
Redeemable 3 per cents.	114·3	3,812
Floating debt	21	1,145
Annuities for life	216·8	—
Terminable annuities, &c.	199·9	3,139
Total	1,245·6	30,096

The conversion of the 3½ per cent. *rentes* will bring the general 3 per cents. to 22,000,000,000 frs. The capital value of the life charges cannot be put at less than 25,000,000,000 frs.

powerful, and in immediate opposition to that of the State.

Some alleviation of the burden may in the future be reasonably expected from (1) the gradual redemption of the 3 per cent. stock created since 1878, a process to be finished in 1952, and (2) from the falling in of the railway property, which, as we saw, will happen at about the same time.[1] But the benefits to be thus received will largely depend on the methods employed in the next fifty years. If deficits are allowed to continue, if injudicious expenditure is carried on, and if new public works are started, it is certain that a fresh debt, perhaps exceeding that now in existence, will be formed by the middle of the next century.

§ 4. Italian unity has, at least from the financial point of view, been purchased at a heavy price. Not only has the weight of taxation been inordinately increased, but a large public debt has been contracted. The new kingdom had to take up the debts of its predecessors, and from its formation up to 1875 each year's budget showed an excess of expenditure over receipts.[2] The use of loans, either openly, or by the issue of inconvertible paper, was the inevitable result. The latter expedient was in force from 1866 to 1883, when it was removed by means of a loan of over £29,000,000 in *specie*. Since then, however, there have been further deficits and an increase of liabilities, so that the total capital of the Italian debt at the close of the 19th century amounted to £514,500,000, involving an annual charge of £23,194,000.[3] About £6,000,000 of this sum has been an inheritance from the earlier States, and the war of 1866 is accountable for part of the balance;

[1] See Bk. ii. ch. 3, § 13.

[2] These annual deficits, 'which began with £15,000,000 for 1860 and rose to nearly £29,000,000 in the war year 1866, became less than £3,000,000 in 1871, and only a little over £500,000 in 1874,' amounted in the aggregate for the fifteen years 1860–1874 to £166,000,000.

[3] The principal stock is the consolidated 5 per cent.; its capital exceeds £320,000,000.

but the great source has been the budget deficits in ordinary years, that have gradually accumulated in the present heavy burdens.

The situation of the German States is in sharp contrast with that of the countries already considered. They are not weighed down by debt charges, and they have the advantage of possessing assets against a good deal of their apparent liabilities. As appeared in connexion with the quasi-private income, the retention of the domain, both agricultural and industrial, has been more marked in Eastern Europe, and this difference in policy has affected the position of the public debt.

The use of a State treasure prevented the employment of loans by Prussia up to the French war of 1792. From that time the public necessities were too pressing, and some debt was contracted, which by 1820 came to nearly £33,000,000 with a yearly charge of £1,140,000, and a sinking fund which brought the total annual cost up to £1,500,000. During the next thirty years the debt was reduced by the sale of public property and by suitable taxation, until in 1848 the interest charge was only £650,000. Between 1850 and 1870 there were increases both for public works and war expenditure, that by the end of the latter year brought the total debt to £66,700,000. Since then the purchase of the railways has added heavily to the nominal debt. The process of redemption has also been carried on to such an extent that there is an actual diminution of the non-productive part. In fact, the railway receipts have in some years more than sufficed to meet their expenses and the whole cost of the interest and sinking fund on the debt. The total debt has grown to nearly £330,000,000, and the interest charge to nearly £14,000,000, but owing to the assets acquired by its means, the Prussian debt is less oppressive than that of any other European country.[1]

The four important secondary States in Germany are

[1] For the Prussian debt, see Cohn, §§ 488–94; Neymarck, 3–6.

somewhat similarly placed. The whole debt of Baden is for railway construction, as is the far greater part of those of Saxony and Würtemberg. Two-thirds of the Bavarian debt was incurred for the same object. As the railways have in recent years contributed more than the interest on their part of the debt, there is a considerable relief to the taxpayers, and if liquidation were necessary, the assets would leave a balance.

At its establishment the German Empire took up the debt of the North German *Bund*, which consisted in loans for the war of 1870–1, amounting to over £30,000,000, and which has been almost entirely paid off. New loans have, however, been issued for extraordinary expenditure—and in the latest case to meet a deficit—which have brought the debt to nearly £120,000,000 with an annual charge of £4,400,000. The various Imperial funds must be placed on the other side of the account; they, as we saw,[1] come to £25,000,000, thus leaving over £90,000,000 as the net liability.

§ 5. The United States, again, have a different debt history from any of the preceding countries, and one that suggests some points of interest. After the adoption of the Constitution, Hamilton prepared and carried a scheme of funding by which the debts due to France and Spain, those owed to natives by the Congress, and lastly the debts of the States, were combined. The total debt was in 1791 $75,000,000. Notwithstanding the creation of a sinking fund, the amount due increased in 1796 to $84,000,000. By 1812 it was reduced to $45,000,000. The war with England led to a greater outlay, which was for the most part met by loans.[2] In 1816 the debt had reached $127,000,000. From that point there was a steady reduction, till in 1835 the total debt was only $37,000, or practically *nil*. During

[1] See Bk. v. ch. 1, § 3.

[2] Out of $70,000,000 war expenditure, $64,300,000 was met by loans, and $5,700,000 out of the tax receipts, or 92 per cent. and 8 per cent. respectively. Adams, *Public Debts*, 124.

the following years some temporary loans were made, as *e.g.* for the Mexican War (1848), and the total debt stood at about $60,000,000 when the Civil War broke out.[1]

The first results of the contest were a serious disturbance of industry and commerce and a great increase of expenditure. No adequate tax-system was in existence, and accordingly the extraordinary expenditure was at first almost entirely met by the use of credit. Treasury notes, culminating in inconvertible paper issues, and funded debt were both employed. It was not until 1864 that the tax revenue was made a really effective contributory to the war expenses, but from that date its development was rapid.[2] Soon after the close of the war the debt touched its highest point. According to Mr. Bolles, 'On the 1st September (1865) the debt recorded on the books of the Treasury reached its maximum, though a large amount of war obligations, pensions, &c., were not yet paid.'[3] This maximum was represented by the sum of $2,846,000,000, of which only $1,110,000,000 was funded debt, and about $460,000,000 inconvertible paper; the enormous sum remaining—$1,276,000,000—was in the form of floating debt, most of it immediately repayable. The cash reserve in the

[1] The smallness of the debt in the period 1836–60 will be best realised from the fact that its capital amount rarely exceeded, and in several years was much under, the annual income of the Federal Government.

[2] The following table shows the relations of loans to tax revenue in the years 1861–66. See Adams, 132.

Year.	Revenue. Million dollars.	Loans. Million dollars.	Total. Million dollars.	Percentage of loans to total receipts.
1861	41·5	23·7	65·2	35
1862	51·9	433·6	485·5	89·5
1863	112·6	595·6	708·2	85
1864	264·6	696	960·6	72·5
1865	333·7	864·8	1198·5	74
1866	558	92·6	650·6	14

[3] Bolles, *Financial History* (1861–1885), 306. According to Prof. Adams, 'the interest-bearing obligations of the United States stood at their maximum in August, 1865, amounting at that date to $2,381,000,000.' *Public Debts*, 249.

treasury was, however, only $88,000,000, leaving net liabilities to the amount of $2,758,000,000.

The great financial problems for the Secretary to the Treasury were therefore (1) to pay off, or fund, the floating debt, and (2) to provide a permanent scheme for the future extinction of the immense liabilities created by the war. The former required immediate attention, and was successfully managed. In a little over two years the floating debt was brought down to $408,000,000, and the inconvertible issues reduced by over $20,000,000, while new funded debt to the amount of $686,000,000 in 6 per cent. bonds had been issued. The temporary obligations were cleared off in 1868, leaving free scope for the repayment, and when possible the conversion, of the funded debt.

A sinking fund law had been enacted in 1862, but as there was no real surplus till 1866 it was inoperative, and in fact the payment of debt has not been carried on in conformity with that law. It has, notwithstanding, been on an immense scale, as the following short table proves :—

Year.	*Capital.* Million dollars.	*Interest Charge.* Million dollars	*Rate of Interest.*
1865 (Sept.)	2756·4	151	6·34
1868 (Nov.)	2484·9	126·4	5·8
1884 (Nov.)	1408·5	47·3	3·92
1889 (Dec.)	1056·1	41	3·7
1892 (June)	585	22·9	3·9

Thus in a little over a quarter of a century $2,100,000,000 was removed from the capital liability, and the annual payment reduced by nearly $130,000,000. This at first sight extraordinary result was due in part to the high credit of the United States Government, which enabled the 6 per cent. and 5 per cent. bonds, as they fell due, to be reduced to $4\frac{1}{2}$ per cent. and even $3\frac{1}{2}$ per cent. A more potent cause existed in the receipt of large annual surpluses, the natural consequence of the high duties on imports. The protective system was in this way the cause of the repayment of the war loans. From the financial

point of view it is plain that a like result could have been reached at much less real cost and sacrifice, if moderate duties had been used; but then it is doubtful whether in that case the policy of repayment would have been so firmly adhered to.

As a result of this vigorous treatment the position of the federal debt ceased for a time to be a prominent question in American finance. Such importance as it had arose in connexion with the management of the treasury and the banking system. The first change in this satisfactory condition was the outcome of the depression of 1891–3. In order to maintain the gold reserve the plan of issuing loans was tried.[1] Owing to the increase of expenditure and the policy of the Tariff Acts of 1890 and 1894 the surpluses which had been realised in every year since 1874 were replaced by deficits,[2] which in the six years 1893–9 amounted to $281,000,000, the war with Spain only accounting for a small part of this sum.[3] Consequently the debt increased from its minimum point of 1892 to $1,046,048,000, *i.e.* an addition in seven years of

[1] See Noyes, *Thirty Years of American Finance*, chs. 9, 10.

[2] The following figures show the position of the United States balances for the last fourteen years:—

Year ending June 30.	*Dollars.* 000's omitted.
1888 ...	119,612 surplus.
1889 ...	105,053 ,,
1890 ...	105,344 ,,
1891 ...	37,239 ,,
1892 ...	9,914 ,,
1893 ...	2,342 ,,
1894 ...	69,803 deficit.
1895 ...	42,805 ,,
1896 ...	25,203 ,,
1897 ...	18,052 ,,
1898 ...	38,047 ,,
1899 ...	89,111 ,,
1900 ...	79,527 surplus.
1901 ...	77,717 ,,

[3] A special 3 per cent. 'ten-twenty' loan of $198,000,000 was issued in 1898 for this war.

$461,000,000, or 78 per cent.[1] The interest charge, in spite of the low interest on some of the loans, also advanced to $40,347,000. The financial years 1899-1900 and 1900–1 have both seen reductions of the capital charge and interest. The process of conversion has been actively carried on, three, four, and five per cent. loans being converted into a two per cent. stock. Thus the $4\frac{1}{2}$ per cent. debt has entirely, and the 5 per cent. very nearly, disappeared, and almost half of the capital bears only two per cent. interest, while the average is less than three per cent.[2] Should the revenue continue to show surpluses as large as those of 1900 and 1901 the practical extinction of the debt will be soon accomplished.

§ 6. The debt systems of other countries need not be considered in detail. They exhibit the same general features, but in some cases afford instructive variations on those already noticed. The most important countries are Austria-Hungary and Russia. In the former there is a separate account for the old common debt existing before 1867, and each part of the dual monarchy has its own debt account. The interest charge for 1902 is £14,750,000 for Austria, and £10,875,000 for Hungary. The combined capital amounts to £550,000,000. The Russian debt has been affected all through its history by the inconvertible paper currency and the autocratic character of the government. In recent years the expenditure on railway extension has been another cause of increase. In 1892 the debt capital was £575,000,000. After ten years it had increased

[1] The highest point was in Nov. 1899.

[2] On June 30th, 1901, the following were the several stocks :—

				$
5 per cent. redeemable			1904	21,854,100
4	,,	,,	1907	257,376,050
				33,320
4	,,	,,	1925	162,315,400
3	,,	,,	1908–18 ...	99,621,420
2	,,	,,	1930	445,940,750
				987,141,670

By March 1st, 1902, the capital charge was further reduced to $937,021,160.

to £693,000,000 with an annual interest charge of £27,600,000.[1]

Another interesting group of debts is that of the British Colonies and dependencies. The Indian debt is about £165,000,000; the Australasian colonies have a total debt of £240,000,000; the Canadian Dominion £70,000,000, and the South African colonies £40,000,000.[2] Most of these sums have been borrowed for reproductive purposes.

One general fact is discernible in the course of the modern history of debts, viz. the universal tendency to increase and in some cases to press dangerously on the limits of national solvency. Any attempt to present the total amount of indebtedness at a given time soon becomes misleading, owing to the growing liabilities of the world.

[1] The assets available against this charge are not easily valued. Much depends on the future policy of the State.

[2] The settlement after the South African War will certainly double this figure.

CHAPTER V

THE THEORY OF PUBLIC CREDIT AND PUBLIC DEBTS

§ 1. THE peculiar position of the state economy and the great importance of public borrowing have both tended to obscure the fundamental truth that public credit is but one form of credit in general, and is, or ought to be, regulated by the same leading principles. Many of the most serious errors in this department of finance have been due to the belief that the State in its borrowing was emancipated from the restrictions that prudence imposed on the individual, and that it might safely indulge in experiments that would soon land the ordinary citizen in bankruptcy.

A reference to the nature of credit shows that a national debt is no creation of wealth; that at best it can only, in Bagehot's phrase, be 'additive' and give greater energy to production. Moreover, this position is only attained where the credit is 'productive,' *i.e.* used in assisting the creation of fresh wealth. Where the resource whose use is obtained by credit serves merely for some object which, however important, is not conducive to economic production, then, either for the individual or for the State, there is so far a loss of material power. Present borrowing of this latter kind implies less income in the future until the loan is repaid. In like manner the limits of individual and public capacity for borrowing are determined on the same principle. Each person can only borrow on his disposable income; a State or subordinate political body must depend

on its quasi-private and tax receipts, and must deduct its necessary outlay. The fund on which a public body can call is that part of the income of individuals that the tax collector is able to appropriate, and it is on its amount that, in the last resort, borrowing power depends.

With regard to the mechanism of public credit the same fact exists. A State entering the money market for a loan stands on a precisely similar footing to the industrial corporation. It must conform to the usual course of business, and it must submit to have its solvency gauged in just the same way—by the price at which it can obtain accommodation. State credit is, then, we may fairly conclude, one branch of the modern credit system, and its general aspect is the same as that of industrial or non-industrial credit, respectively, in the case of private economies.

§ 2. But though this general conclusion is abundantly warranted, and may be usefully employed in dispelling certain fallacies on the subject, there remain for notice some special features of public economy that give a peculiar colour to its borrowing, more particularly in the case of the central government. The sources of individual wealth reside in property or personal capacity to earn; it is from them that all private income comes. But the State's revenue is mainly derivative; it can compel the taxpayers to supply it with funds. The method of borrowing is therefore naturally suggested, where heavy taxation is for the moment undesirable, and is further encouraged by the fact that public credit has the advantage of resting on a broader and more enduring basis. So far as a public domain is in existence, loans may be regarded as virtually mortgages raised on its security, as many early loans actually were in form, as well as in fact.

A second peculiarity of public economy is the difficulty of sudden retrenchment in its case. The individual, or even the industrial company, can cut down expenses, if receipts fall below their former level. Their expenditure is more elastic than that of the State. Decline in revenue receipts

will not justify the disbanding of the army, or the dismissal of civic officials. Consequently, when under any given state of things a deficit is imminent, and new taxes are not for the moment available, borrowing is necessarily prescribed.

This apparent disadvantage is compensated by the greater permanence and wider field of public economy. Whatever may be the disasters of a few years,[1] the normal feature during centuries is a growth of national wealth and income that it takes more than ordinary misgovernment to dissipate. We may readily explain the special forms of state loans by reference to this circumstance. The great variety of stocks and the complicated conditions for repayment could only be adopted by a body of assured continuance and growing resources, and in this respect the greater industrial corporations, that also have the prospect of long existence, present an instructive resemblance.

More important than any of the foregoing is the peculiar legal position of a debtor State. Unlike the private citizen or corporation, it rests within its own discretion to say whether or not it will meet its obligations. The creditor who wishes to enforce his claim against a State has not at his command the usual legal machinery, the necessity of which is proved by the frequent recourse to its aid.[2] A national bankruptcy is a strictly legal proceeding, *e.g.* an Act of Parliament repudiating the National Debt would be quite as valid as any other measure. This privilege, which is inherent in any form of sovereignty, has been further extended to—or more accurately speaking retained by—such subordinate political bodies as the 'States' of the American Union, which at one period of their history extensively availed themselves of it.[3] But where no trace of

[1] Thus the situation of France in 1871 was an entirely unexpected one, and could be no criterion for judging the usual position of that country.

[2] The peculiar treatment of Egypt and Greece is noticeable, as indicating the tendency towards international regulation in the case, not only of non-sovereign, but also of small independent States.

[3] The 'repudiations' of 1840–50 are the best known examples.

supreme power remains, this exemption disappears, and the ordinary local governments are as amenable to legal process for recovery of debts as any other kind of corporation.[1]

Though released from legal liability, the sovereign State is in practice under very powerful inducements to pay its way. In the first place, if its creditors are foreigners, a failure to fulfil its agreement lays it open to remonstrance on the part of the foreign States affected, and possibly to even more rigorous measures. The domain of international law is not yet a settled one, and it is quite conceivable that the observance of obligations to alien lenders may be one of its rules in the future.[2] With regard to native creditors there is an obvious interest on the part of the State to do nothing that will injure them, and whatever political power they possess will surely be used in their own defence. Stronger than either foreign or domestic influence is the economic sanction that protects the security of loans. The repudiating State shuts itself out from the future use of credit for the sake of a temporary gain. A national bankruptcy is a bar to any later borrowing unless on ruinous terms. The American 'States' have never recovered the shock that repudiation inflicted on their position as borrowers. The best support to the policy of paying in full is derived from the economic advantage that a reputation for honesty secures 'in the long run,' and nations, it must be remembered, have a far greater interest than individuals in paying attention to what happens 'in the long run.'

§ 3. The earlier theories on the subject of public credit were little more than the formal statement of popular prejudices. Ideas similar to those of Law on the nature of credit were somewhat widely diffused. Thus we find the

[1] It must, however, be remembered that the method of procedure may often be complex, and make recovery of the debt difficult, if not hopeless.

[2] The case of Greece, just referred to, and the possible difficulties of European States with the South American Republics may be referred to.

public funds described as 'a mine of gold,' and state loans as 'realised alchemy.'[1] Credit was looked on as a fresh creation of wealth, and therefore public debts were naturally regarded as affording a clear addition to the national possessions. Less extreme, but just as erroneous in principle, was the assertion that the debts of the State were quite unimportant, as they were merely due by the right hand to the left.[2] This position—an evident deduction from the cruder mercantile doctrine—was strictly applicable only to the domestic debt, and was so limited by Voltaire and Condorcet. Foreign creditors, it was thought, did take money out of the country, and therefore injured it; the resident received his interest, and spent it at home. There is little difficulty in exposing this fallacy, which really rests on the same ground as certain views about expenditure and taxation already rejected.[3] The action of indebtedness on the economic system cannot be altogether without influence or effect, nor can the consumption of masses of wealth be of itself beneficial. The confusion—not altogether unknown in later writers—between wealth and evidences of ownership is the reason for the belief that public debts are an addition to the material resources of the nation. Though in some respects the existence of debt may be the cause of new wealth creation, this interpretation of its effects must be dismissed as erroneous.[4]

§ 4. But the growth of debts in England and France in the eighteenth century produced a very different opinion on the subject in the case of the most prominent writers on political and social matters. Montesquieu did not hesitate to condemn public debts; he refutes the idea that they are

[1] The former is Berkeley's account, *Querist*, No. 233; the latter phrase is used by Pinto, a Dutch writer. Roscher, § 125, note 1.

[2] 'Les dettes d'un État sont des dettes de la main droite à la main gauche, dont le corps ne se trouvera point affaibli.' Melon, *Essai Politique*, ch. 23 in *Économistes Financiers du 18me siècle*, 749.

[3] Cp. Bk. i. ch. 8, § 6, and Bk. iii. ch. 2, § 2.

[4] Macleod's theory of credit is tainted by this fault.

advantageous, and approves of the English conversion and sinking fund.[1] Hume is even more pronounced. Though declining to 'waste time in declaiming against a practice which appears ruinous, beyond all controversy,' he yet states very forcibly his objections, some of which had been already given by Montesquieu. The high authority of Adam Smith is on the same side. He speaks of 'the enormous debts which at present oppress, and will in the long run probably ruin, all the great nations of Europe,' and his whole discussion of the funding system is in an extremely hostile tone.[2] Both Hume and Adam Smith prophesied that national bankruptcy would be the outcome of the continuous English borrowing. The course of events has falsified this prediction, and later writers have not hesitated to pronounce it fallacious. According to Macaulay 'the prophets of evil were under a double delusion. They erroneously imagined that there was an exact analogy between the case of an individual who is in debt to another individual and the case of a society which is in debt to a part of itself. . . . They were under an error no less serious touching the resources of the country.'[3] The former part of this criticism is more than questionable. In all essential points the analogy between the public and private debtor does hold good, and should never be lost sight of. It is no doubt true that the material power of England was under-estimated, but then it was impossible to foresee the Industrial Revolution and its extraordinary results. The real error of Hume and Adam Smith lay in generalising from a too limited experience, and in assuming that no new forces would come into operation; just as Macaulay has probably erred in the opposite direction when he declares that 'a long experience justifies us in believing that England may, in the twentieth century, be better able to pay a debt of £1,600,000,000

[1] *Esprit de Lois*, Liv. xxii. chs. 17, 18.
[2] Hume, 'Essay on Public Credit.' *Wealth of Nations*, 387.
[3] *History of England*, ii. 400.

than she is at the present time to bear her present load.' The true view, which regards the debt as a pressure on an elastic body, implies the necessity of measuring both the weight and the expansive power of the object on which it presses.

The French war and the accumulation of debt that it caused brought forward Sinclair as a moderate supporter, and Hamilton as a vigorous critic, of the system of borrowing. The former maintains that public loans are the necessary result of the new method of conducting warfare, and compares their advantages and disadvantages.[1] Hamilton's work expounds with remarkable clearness the general rules applicable to the management of debt, and contains among its fundamental principles the following proposition: 'If the periods of war, compared with those of peace, and the annual excess of the war expenditure, compared with the annual savings during the peace establishment, be so related, that more debt is contracted in every war than is discharged in the succeeding peace, the consequence is a perpetual increase of debt; and the ultimate consequence must be, its amount to a magnitude which the nation is unable to bear.'[2]

Now, this is merely the statement in hypothetical form of the condition from which Adam Smith and Hume drew their dismal conclusions, and, as expressed, it is absolutely incontrovertible. A nation cannot, any more than an individual, keep adding continually to its liabilities without at last coming to the end of its resources.

The influence of Hamilton's teaching, which we shall have to notice again in respect to the method of repayment,[3] is plainly traceable in Ricardo's 'Essay on the Funding System,' in which he declares his preference for taxes over loans, chiefly on the grounds that (1) imprudent expenditure will be checked by the dislike felt for heavy taxation

[1] Sinclair's *History of Revenue*, Pt. ii. ch. 2, i. 350 sq.
[2] Hamilton, 9.
[3] Bk. v. ch. 7, § 3.

and (2) the probability that taxation will fall on revenue, while loans usually come from capital. Thus the main current of economic opinion was decidedly opposed to state borrowing.

§ 5. A comparatively novel view of the effect of public borrowing—though the germ of the idea is in Ricardo's essay—was given by Chalmers, who in his *Political Economy* (1832) argued that the loan system was economically disadvantageous and oppressive to the labourers. He maintained that, whatever method be adopted, the whole amount must be taken within the period, but that by taxation the charge is spread over the whole revenue of the society, while by borrowing it is placed on that part of circulating capital that goes to reward the labourers, and, as a necessary consequence, lowers their remuneration to the benefit of the capitalists. In fact, in his opinion, the system of borrowing puts double pressure on the country that adopts it; for there is the original sacrifice when the loan is contracted, and the later one involved in the payment of interest, so long as it remains outstanding, and finally in its repayment. The practical conclusion that follows from this train of reasoning is of course that no borrowing should ever take place, and that all expenditure should be met out of current revenue.[1]

It is highly probable that Chalmers's argument, like many of the ingenious points made by the secondary writers on economics in the first half of this century, would soon have been completely forgotten, had not J. S. Mill seized upon and repeated it in an early chapter of his *Principles*. He asserts that the doctrine is substantially correct, though needing qualification, owing to the possibility of the migration of capital;[2] and in a later part of his treatise he endeavours to assign what is clearly an erroneous criterion, by which the real effect of any actual loan could be determined.

[1] Chalmers, *Political Economy*, ii. 71 sq.

[2] *Principles*, Bk. i. ch. 5, § 8, Bk. v. ch. 7, § 1.

This curious doctrine is evidently based on an application of the wages-fund theory in its most rigid form, and the general abandonment, or at least qualification, of that dogma would of itself suggest serious doubts as to the soundness of any deduction from it. As we shall see in a later section, the argument is almost wholly untenable, and rests on a very partial interpretation of some economic conditions peculiar to the time at which it originated.

§ 6. The exigencies of practical finance had made the use of borrowing so general that the more practical students of the subject recognised the necessity of the loan system. In Germany especially is this view to be found. Jacob, Malchus, Rau, and Nebenius, while all dwelling on the evil effects of loans, accept them as a legitimate expedient. The arguments of Adam Smith were blended with the results of positive experience, and if the combination was not always consistent, it at least had the merit of being eminently common-sense.[1]

The same judgment can hardly be passed on a later German theory, originated by C. Dietzel, which regards the loan system as the true mode of defraying extraordinary expenditure. This view, which has been already noticed in another connexion,[2] regards the State as being a part of the immaterial capital of the society, and any unusual outlay for its service as, in fact, an investment. To charge to revenue what is really due to capital is therefore a mistake in public bookkeeping, and, what is far worse, an injustice to the actual taxpayers. So contemplated, the issue of loans becomes a normal part of the working of a progressive State. Instead of regarding the process as wholly condemnable, or at best as a necessary evil, we should, it is maintained, look on it as both just and beneficial.[3] The upholders of the theory have arrived at a

[1] On these writers see Cohn, §§ 511–14; Roscher, *Geschichte*, §§ 152, 160, 195.

[2] Bk. i. ch. 8, § 1.

[3] See C. Dietzel, *System der Staatsanleihen*; Stein, iv. 421; Wagner, i.

diametrically opposite position to that occupied by Chalmers, and one which, if generally adopted, would produce very serious practical consequences.

§ 7. A criticism of the preceding doctrines supplies the first steps towards a true theory of public debt. The idea of Chalmers that the system of borrowing presses too heavily on the labouring class can be easily shown to be fallacious. In the first place, it is not true that all loans come from capital; they may be obtained from savings made for the purpose.[1] The prospect of a new and secure investment is a stimulus to abstinence, and so far as it is operative the labourers will not suffer. But even granting this erroneous assumption, it by no means follows that loans derived altogether from capital are taken from wages. 'The loan,' says Mill, 'cannot have been taken from that portion of the capital of the country which consists of tools, machinery, and buildings. It must have been wholly drawn from the portion employed in paying labourers.'[2] He, however, offers no proof, or attempt at proof, of this proposition, which is plainly untrue. The amount taken in loans comes at first from floating capital that would otherwise have been applied to fixed capital, raw material, or the payment of workers in proportions determined by the actual circumstances. Again, the effect of the employment of the loan is altogether disregarded.[3] In so far as it is expended on hiring services it actually tends to raise wages, so that, reasoning from the wages-fund position, what is taken by the abstraction of capital is restored by the outlay of the borrower on labour. The utter unsoundness of the doctrine that all loans come from wages will appear from the absurd result to which it leads—viz. that where wages are at the minimum it would

144 sq., for statements of the doctrine. Cohn, §§ 515–7, supplies a pointed criticism.

[1] This was probably true of part of the French loans of 1871–2.

[2] *Principles*, Bk. i. ch. 5, § 8.

[3] Mill briefly refers to this point in a footnote to his later editions, Bk. i. ch. 5, § 8 (6th ed.).

be impossible to borrow without starving some of the workers.[1]

The facts that public loans are in many cases international, and that in any event capital is capable of migrating from country to country, are allowed by Mill to have weakened the theory that we are considering. If loans really come from the international market, any pressure must fall on the labourers of all the countries which contribute—*e.g.* South American borrowings would have injured English labourers. He is therefore led to suggest that so long as public borrowing does not raise the rate of interest, the labourers are not damnified. This qualification is again unsound; for every loan must, *pro tanto*, tend to raise the rate of interest or to keep it from falling. There is no line or wall of separation between capital for home and that for foreign investment.[2] The growth of international relations has rendered antiquated any argument from the hypothetical case of an isolated country.[3]

Such considerations as the foregoing make it difficult to understand the acceptance of the doctrine by Mill. The explanation is to be found partly in a special case which seemed to give it support, and partly in a portion of truth that it did, in fact, contain. The great instance of state borrowing known to Chalmers and Mill was that by England in the period 1793–1815, and at that time the labourers were suffering, while the capitalists seemed to prosper. The real causes were of course different,[4] but the concomitance

[1] Mr. MacDonald (*Economic Journal*, xii. 24–28) misapprehends the doctrine of Chalmers which he criticises.

[2] Mill, *Principles*, Bk. v. ch. 7, § 1. His error has been exposed both by Cairnes, *On the Best Method of Raising the Supplies for War Expenditure*, 10, 11, and by Cliffe Leslie, *Notes* (privately printed), 17, 18.

[3] For a clear statement of the modern mobility of loan Capital see Cunningham, *British Association Report* (1891), 727.

[4] The labourers' sufferings were really due to the continued bad harvests, the depreciated paper money, the restrictive laws against labour, the old Poor Law, the check to imports by war, and the industrial revolution. The capitalists gained by the greater use of machinery and the command that England at times obtained over the supply of foreign markets.

of the two series of facts gave a plausibility to the theory that it would not otherwise have had. The element of truth contained in it was that public borrowing is a demand for loanable capital which helps to raise its value—*i.e.* the rate of interest.[1] Higher interest leaves less for the other shares in distribution, and as the employer and the landlord were able to hold their own, the pressure fell on the labourers; but this could not be ascribed solely to state borrowing. Taxation that really fell on capital would have the same effect. We cannot therefore adopt, as a sweeping and absolute rule, the proposition that the State should never at any time obtain funds by borrowing.

§ 8. The opposite theory, which puts forward the loan as a normal process of meeting expenditure of the extraordinary class, is open to quite as weighty objections. The expenses of the State do, no doubt, vary from year to year, and any sudden increase which has to be met by taxation may prove inconvenient, but on the other hand we have to remember that so-called 'extraordinary' expenditure is itself recurring.[2] To treat all fresh claims as extraordinary, and to meet them from loans is an easy, but a dangerous course. There is also the further consideration, that in the long run the revenue from economic receipts and taxation must, if the State is to remain solvent, balance the outlay. So far as debt is not redeemed it is a permanent charge on the revenue, while its redemption must come from that source. If, taking a somewhat lengthened period, we find that the ordinary state revenue meets expenditure, there is no reason why—special emergencies excepted—it should not do so in each financial year. Sudden changes in taxation may be more or less inconvenient, but the system should be such as to secure some elastic sources of revenue. The English income-tax is capable of discharging this function, and the duties on commodities would also allow,

[1] Cp. Sidgwick, *Pol. Economy* (1st ed.), 323, for the possible effect of inventions in so raising the rate of interest as to injure labourers.

[2] Cf. Bk. i. ch. 8, § 1.

in case of need, of large increases. A theory that so markedly separates ordinary from extraordinary expenditure, and assigns different funds for their immediate payment, errs by unduly emphasising a non-essential distinction.

That borrowing is justifiable to meet 'reproductive' outlay is a further part of the theory, which is at once true or false according to the meaning given to the term. Actual purchase of productive property or creation of revenue-yielding works may fairly be defrayed by loans. The property or particular work may be regarded as the primary object of the debt, and is at hand to pay the interest on it. What we have called 'economic' outlay has a claim to be met by borrowing that does not hold in respect to other forms. Taxation imposed for the purpose of adding to the domain has the disadvantage of taking the citizens' wealth for the purpose of accumulation, and should be employed sparingly, if at all. To meet the cost of the purchase of the Prussian railways, or even of the English telegraphs, by immediate taxation, even were it practicable, would not be correct.

This concession to the policy of borrowing should not be stretched to include the cost of works or other state action that yields no revenue. Non-economic expenditure is primarily to be met out of income, and unless it can be so dealt with ought not be incurred. National culture, education, the promotion of social progress are all most desirable; but their promotion is not so urgently required as to need the use of borrowing by the public powers. It is, indeed, true that much of state expenditure may be regarded as indirectly productive, and as likely to add to the national income in the future. A loan for the purpose of extending education, or for improving the housing of the workers, though it does not directly provide the interest needed, may yet so increase the income of the community as to make the tax receipts greater, without any increase either in rates or in rigour of collection. Regarded in the

abstract such a proceeding seems defensible; the real objections to it arise from the difficulty of application. The results of expenditure of the kind are hard to trace or measure, and any statement respecting them must rest in a great degree on conjecture. The cost of the loan is definite and precise, and it constitutes a real burden on the resources of the society. Prudence seems accordingly to suggest that borrowing should hardly ever be adopted except for strictly economic expenditure, and then only when the extension of the state domain is clearly advisable. Political and social conditions come in to limit the purely financial action of the public powers.[1] With an individualistic organisation of society the extension of public industries has naturally to be kept within narrow bounds, and will not comprise all possibly gainful employments.

One great objection to the use of borrowing, unless there is an equivalent revenue obtained by its application, is the necessary curtailment of the future power of spending. Large immediate outlay may, as we shall see, be requisite in certain cases, but for most of the usual forms of state activity the funds obtainable by taxation are quite sufficient, and can be continually renewed. Each year meets its own expense without causing any unevenness in the employment of the fund to be devoted to the purpose. Heavy borrowing, on the other hand, if persisted in for several years, so cripples the ordinary revenue as to compel retrenchment, or further borrowing on disadvantageous terms, until the limit of solvency is touched. This appropriation of resources that will surely be needed in the future is a grave weakness in the borrowing policy.

§ 9. We have now to examine the real effects of the system of borrowing, and for this purpose it is requisite to clearly distinguish between the mere mechanism of a loan, and the actual economic phenomena that are its outcome. Reduced to its simplest form, a loan is a transfer of so

[1] See Bk. i. ch. 1, § 2 for this peculiarity of public economy, and cp. Bk. ii. ch. 3, § 21.

much of the wealth of private holders to the State or other public body. By its aid the borrower obtains the disposal of the wealth in question, and as a consequence affects, or can affect, the production, distribution, and consumption of wealth. Thus we cannot doubt that the enormous English loans during the Revolutionary and Napoleonic wars had a powerful influence on the economic condition of the country, and we must believe that other cases of borrowing so far resembled this particular one. The application of public loans is, therefore, to be taken into account when seeking to estimate their effects. If contracted for a purely industrial purpose—say railroad construction—it is quite conceivable that their influence on the state economy may be almost imperceptible. It may even happen that the actual application will be the very one that private capitalists would have selected for their investment, in which case the public credit is only interposed as an intermediary between the real investors and the industry in which the wealth is placed. There is, of course, the additional complication of public management, but in essence the State is an unnecessary additional wheel in the mechanism.[1] The expediency of borrowing for reproductive purposes accordingly depends on the policy to be pursued in reference to public industries. Where, as in Australasia, there is a decided tendency to keep certain classes of works under the public authorities, the policy of borrowing is by that fact justified.[2]

Turning to the opposite case of loans applied unproductively, the first effect is the diminution of capital and the resulting loss of wealth. The typical example is that of a loan for carrying on war. Its use is turned from the support of productive industry to the purchase of commodities and services to be employed unproductively. It

[1] The profitableness of such a method is, generally speaking, more than doubtful, but the Prussian railways may again be cited as an exceptional case.

[2] The occasional depressions in colonial securities and the difficulty at times of procuring fresh loans illustrate the danger that attends such a system, and the need for caution in its use.

is, however, important to note that this distinction is not the consequence of borrowing, but of the circumstances that have led to its destination: it results from the extra expense, not from the particular mode of meeting it.

But granting that the primary cause of the economic disturbance that accompanies extensive public borrowing is to be found in the forces that have produced the increased state expenditure, it does not follow that the system of meeting that outlay by loans, instead of by taxation, has not a serious influence on the economic conditions of the society especially as there are, beyond dispute, some pointed contrasts in the action of loans and of taxes. The first, of these has been already emphasised in Chalmers's theory. A loan, it is said, comes from the nation's capital; taxes from its annual income; the former reduces the fund that assists production; the latter curtail immediate enjoyments. By borrowing we are sacrificing the permanent interests of the country for the sake of immediate relief. That there is some truth in this position is undeniable, but it is very easy to exaggerate its importance. The sharp line thus drawn between revenue and capital does not, in fact, exist, as there is an evident reaction of each on the other. Revenue is, indeed, the spring from which capital is fed, or rather at any given time 'revenue' and 'capital' are but names for different applications of the collective wealth of the community.[1] Large public borrowing stimulates saving, and thereby checks expenditure on enjoyments, while oppressive taxation reduces the fund from which new savings are made, and so far hinders the accumulation of capital. A loan for unproductive purposes is not always a pure destruction of national capital. Though the debt charged on the national wealth is

[1] Cp. Bk. iii. ch. 2, § 5, and for a discussion of the conception of revenue see Marshall, *Principles*, Bk. ii. ch. 4, §§ 3, 4, (3rd ed.). Prof. Fisher and Mr. Cannan urge that the distinction between 'capital' and 'income' turns on differences in respect to *time*, *Economic Journal*, vi. 509 sq., vii. 199 sq., 278 sq.

increased, there may be some compensation in the larger available assets.

A second point of contrast is in favour of borrowing. A loan is voluntary, and supplied by willing givers; taxation is levied on the willing and unwilling alike, and, if heavy, is sure to cause discontent. The former has, therefore, the advantage of putting less immediate pressure on the individual citizen, though on the other side there are the future charges, and the effect on borrowers and labourers through the increased value of loanable capital to be taken into account.

Thirdly, the equitable distribution of heavy taxation is not easily attained. Where very high imposts are laid some classes and persons are likely to suffer unduly. The division of the charge over a longer period by the use of borrowing makes the proper apportionment of the burden far easier, and more especially allows of sufficient time for its full consideration. Great and sudden changes in taxation—particularly if they are increases—are always evil. Some time is needed for the definitive incidence of a tax to become settled; a truth exaggerated in the doctrine of Canard, but still having much weight in this special connexion. It might even be said that, to avoid disturbance, taxation should always be maintained at a level sufficient to meet the average outlay over a long period. Excessive expenditure in some years would thus be compensated by savings in others, and complete equilibrium between income and outgoings would be the final result. The utter impossibility of forecasting the future course of expenditure makes this method quite impracticable. The effort to carry out such a plan would end in an accumulation of debt that would not be paid off in the prosperous periods. But though so thorough an adjustment is not to be reached, the diffusion of the burden of loans, in opposition to the immediate pressure of taxes, is a difference to be taken into account in considering their respective operations.

The contrast may also be turned the other way. Just

as direct taxation is often advocated on the ground that it brings the real cost of the State more clearly before the contributors, so has the policy of paying all expenses out of taxation been regarded as 'a salutary and wholesome check' on the natural disposition to indulge in extravagant outlay. To make things smooth for the present at the cost of the future is not the duty of the wise and far-seeing statesman.

Loans for war expenditure are particularly open to this objection, and it was in reference to them that Mr. Gladstone pronounced his forcible condemnation of the policy of borrowing.[1] There can be no doubt that the immediate increase of taxation will to some extent damp the ardour of a people for war, which, however, is sometimes a doubtful advantage. From the point of view of the administration the method of borrowing is decidedly preferable; as, where taxes have to be imposed it is necessary to exercise economy and to keep expenditure within bounds, while by the use of loans a government may even secure favour with the moneyed interest, and at the same time become popular amongst other classes by profuse outlay.

Lastly, there is, or there may be, an opposition between borrowing and taxation in respect of their ultimate incidence. With proportional taxation increased to meet abnormal expenditure there is very heavy pressure on the receivers of industrial, or more generally of temporary, incomes, which may have ceased to exist when the burden is removed. In the succeeding period of low expenditure the same class of incomes escapes lightly, though the recipients

[1] 'The expenses of a war are the moral check which it has pleased the Almighty to impose upon the ambition and the lust of conquest that are inherent in so many nations. There is pomp and circumstance, there is glory and excitement about war, which, notwithstanding the miseries it entails, invests it with charms in the eyes of the community, and tends to blind men to those evils to a fearful and dangerous degree. The necessity of meeting from year to year the expenditure which it entails is a salutary and wholesome check, making them feel what they are about, and making them measure the cost of the benefit on which they may calculate.' *Hansard*, March 6th, 1854. Cp. the useful criticism in Northcote, *Financial Policy*, 259–264.

have benefited by the sacrifices previously incurred. This failure in just distribution between different times may be met by the loan system, the interest on debt being paid by those who would otherwise have escaped altogether, but as we saw,[1] it can also be avoided by the use of taxes falling on property, such as succession duties, or direct imposts on realised wealth, though this course is surrounded by difficulties of its own.[2]

§ 10. So far the contrast of borrowing and taxation as modes of meeting extraordinary expenditure, does not seem to lead to any very decisive result. Some broad considerations favour the use of taxation: others of no slight weight give support to, at least, a moderate use of loans. But, in truth, there is not quite free choice. After expenditure has passed a certain point, borrowing becomes, if not necessary, at all events highly expedient The productiveness of every separate tax has its limits, and so has that of the tax-system taken as a whole. Each additional charge implies a more than proportional sacrifice by the contributors, and greater difficulty in getting in revenue on the part of the State. The existence of the condition of 'diminishing returns' in public receipts is a valid ground for the employment of loans, when, all things considered, they will be less onerous than further taxation. It appeared that 15 per cent. was probably the largest proportion of the national income that, under ordinary conditions, could be taken for the state services, and though the limits of productivity are capable of being expanded at times of trial, we can hardly doubt that an income-tax of five shillings in the pound would prove too much for even the United Kingdom.

This principle admits of more extended application. If, when taxation is exhausted, a loan has to be employed, it is evident that before that extreme point is reached,

[1] Bk. iii. ch. 3, § 12.

[2] On this ground the imposition of a property tax to contribute to the cost of the South African War would have been justifiable.

borrowing may advantageously be combined with taxation, and that the exact extent to which it should be used will depend on a complicated calculation of the different elements involved. The cost of taxation, varying as it does according to its forms and amount, must be weighed against the burden, present and future, of the loan. This is no easy matter, and it can only be approximately worked out, if, indeed, it has not to be decided at once by the insight and instinctive knowledge of the statesman, who will be guided as much by the political, as by the purely financial conditions.

The practical solution is not, however, so difficult as would appear from the preceding paragraph. A good tax-system requires as one of its qualities a considerable amount of elasticity, and, as far as possible, the first appeal should be made to taxation. The English income-tax is a valuable instrument for this purpose—as its employment in the Crimean, and, again, in the South African War shows—and its place in this respect is with difficulty filled by other taxes. Still, the customs and excise, if moderately well administered, will allow of increases for a special emergency. Tea, wine, and beer would bear much heavier duties in England, and sugar has proved to be a productive object. Some of the duties on 'acts' could also be advanced in case of need, and would soon yield a larger return.[1] Thus, even if the actual expenses are at first met by creating a floating debt, the new duties will speedily pay off what has been incurred. But when the limits of ready expansion are

[1] Professor Adams (*Public Debts*, 94) objects to the use of the income-tax for the purpose described in the text, but it seems on insufficient grounds. He hardly makes due allowance for the speedy yield of new taxes. 'The financier,' he thinks, 'may hope for assistance from his new taxes within eighteen months of their levy,' *ib.* 140. The first duties would surely come in much sooner. Speaking of the income-tax Mr. Blunden remarks, 'A further great merit in the tax is the promptitude with which its machinery can be brought into operation, the flow of funds in response to an increase of the rate beginning almost at once, and the full addition for the year being brought into account within from nine to fifteen months, according to the period of the year at which the increased rate is decided upon.' *Economic Journal*, ii. 642.

reached, a loan is the suitable mode of obtaining further supplies. Where there is a pre-existing debt in course of redemption, the suspension of that process will add to the available funds,[1] while if there is no debt, the light taxation previously levied can be largely increased. This last consideration suggests a disadvantage in the existence of a permanent debt, in that it brings future borrowing nearer, by imposing so much additional charge on the annual revenue, and thereby reducing the disposable balance.

The probable duration of extraordinary expenditure is an important element in determining the mode of providing for it. A sudden and large demand for a single year may well be met by borrowing (unless the movable taxes and the suspension of debt redemption suffice), as it would not be desirable to disturb the whole tax-system for such a purpose. Where there is a fair prospect of continuous outlay on the increased scale, a readjustment of taxation at the outset is the prudent course.[2] Failure in this cardinal point of sound finance was the cause of the great accumulation of debt in England at the opening of this century, and was also noticeable in the treatment of war expenditure by the United States both in 1812 and 1861, to which instances the treatment of the French expenditure for the Crimean War, and recently that of England in South Africa, may be added.[3]

On the whole, then, the rules applicable to the treatment of abnormal outlay for other than economic purposes may be stated as follows :—(1) Expenditure should, as far as possible, be met out of the annual receipts, and therefore increased outlay should be balanced by heavier taxation.

[1] In England, *e.g.*, the suspension of the terminable annuities and the new sinking fund,—which was employed in 1885, and again from 1899 to 1902—provides nearly £5,000,000 for meeting the fresh expenditure.

[2] For the passage of 'extraordinary' into 'ordinary' expenditure see Bk. i. ch. 8, § 1.

[3] For the weak treatment of the English debt see Bk. v. ch. 3, § 4; for the American instances, Adams, 112–133; Ross. *Sinking Funds*, 21–82; for the French one, Bk. v. ch. 4, § 2.

(2) In the case of non-recurrent expense of large amount, a loan is preferable to a serious disturbance of the normal tax-system, and may fairly be employed. (3) Where the abnormal expenditure extends over a series of years, the various forms of taxation should, speaking generally, be adjusted to meet it. (4) This general principle, however, fails where either (*a*) it would be impossible to secure an equitable division of the heavy taxation necessary, or (*b*) where the limit of productiveness with regard to the several taxes would have to be exceeded, or finally (*c*) where for political reasons it is inexpedient to press heavily on the taxpayers. Under any of these conditions resort to loans as a supplement to the tax revenue even for a somewhat lengthened period is defensible.

§ 11. The fact that part of the funds obtained by public borrowing is derived from abroad is of some weight in judging the loan policy. Not that a foreign loan is in its purely financial bearings so different from a home one as is sometimes supposed, but that the possibility of drawing on the capital of other countries weakens the argument in favour of taxation on the ground that, in any event, the expenditure must be met from the national resources. When taxation fails to respond to new demands, a foreign loan may supply the necessary sums, and the competition of alien with native lenders will enable the state to borrow on better terms, and with less effect on the rate of interest, and therefore to the advantage of the labouring class. But from a purely financial point of view the source of a loan is really immaterial. In any case it is an immediate relief to the taxpayers, counterbalanced by greater charge in the future. Whether the wealth to be consumed in the outlay, which is the primary cause of borrowing, be derived from the stores of home or foreign lenders may have some immediate influence, but when we bear in mind the close connexion of all the countries of the world, and the great mass of private borrowing from foreigners, it is evident that the distinction may be easily exaggerated.

The political and economic effects of the greater mobility of loan capital in recent times are highly important, and deserve careful study, but they do not belong to public finance. The possibility of political complications in consequence of a default in the payment of foreign creditors has been previously noticed.[1]

§ 12. Some important questions arise respecting the absolute amount of public debts, the pressure that they impose on the borrowing States, or other bodies, and the best mode of measuring that burden. For this purpose very different methods may be used. The most obvious is that which takes the nominal capital of the debt as the basis of measurement. Thus, in 1870, France and the United States had approximately the same capital debt,[2] and therefore, it might be said, an equal liability. The defect of this method is evident from the fact that it takes no account of the interest on the borrowed capital, which latter, is moreover, not payable at the creditors' demand. 'The public debt,' as Lord Grenville put it, 'consists not in capital but in annuities,'[3] and the capital amount of debt is therefore no guide to the actual burden that it imposes. A second method might be employed by which the actual, instead of the nominal capital value, or in other words the market price of the stock, would be used as the test, but this again is open to the objection that the real value is incessantly fluctuating, and at any given time represents only the value of the small amount sold, not of the total mass of stock.[4] A third mode, by which a very different result will usually be reached, takes the interest charge as the measure; *e.g.* in the

[1] Bk. v. ch. 5, § 2.

[2] France had £550,000,000, the United States, including the 'State debts, £532,000,000, as their respective capital liabilities. Leroy-Beaulieu, ii. 597. The French debt, so far as the central government is concerned, is probably here placed too high, but it serves as an illustration of the principle.

[3] *Essay on Sinking Fund*, 29, quoted by McCulloch, note 33 to *Wealth of Nations*, 632.

[4] Cp. Jevons' *Theory*, 119, 120, for this distinction.

just-mentioned case of France and the United States, as the former had most of its stock at 3 per cent., while the latter paid 6 per cent. on much of its obligations, the comparison was altogether in favour of France.

All the foregoing methods deal with the absolute amount of the several public debts, and of themselves furnish but a slight clue to the sacrifices undergone by the people of the country. For this purpose a further combination is necessary, and the most popular plan is to divide the capital or the interest charge by the number of the population, and so get the charge 'per head.' How fallacious any test of the kind must be, has been already shown in respect to expenditure;[1] and it is equally plain here, as a comparison of the debts of England, the United States, and Victoria against those of India, Italy, and Russia, suffices to prove. The mere population of a country, any more than its area, is no measure of its wealth and financial capabilities, which must depend on so many different circumstances.

A far better test would be the relation of debt to the national revenue, or, again, to the collective wealth of the society. Such comparisons are, however, by no means easy. The annual income—and especially that part of it which is disposable—must always be more or less doubtful, and estimates of national wealth, whatever method be employed,[2] have even less chance of approaching accurately the real position. Nevertheless inquiries of the kind give a good rough result, and in relying on them we may fairly compare the annual charge of the debt with the national revenue, and in like manner its capital value with the sum of national wealth. The annual charge of £23,000,000 for the English debt should be compared with the £1,400,000,000 of national income, as the £750,000,000 of capital—subject to whatever deduction may be required

[1] Bk. i. ch. 8, § 4.

[2] The best methods are: (1) that of Sir R. Giffen, which capitalises income, and (2) that of M. de Foville, which takes the property changing hands by succession as the base of calculation. Giffen, *Growth of Capital*; De Foville, *La France Économique* (1887), 437 sq.

for its being under *par* value—should be placed against the £12,000,000,000 which may be taken as the sum of British wealth.[1] In this way we get less than two per cent. as the proportion of income, and over six per cent. as that of capital assigned to the public creditors. This great discrepancy indicates the omission of some important element in the capital estimate, which can be no other than the capitalised earning power of the human beings who make up the community. Wages, and industrial and professional earnings, are a part of the revenue, but not of the ordinary capital account of the nation.[2]

For practical purposes it is often convenient to take the proportion of the total state expenditure required for the payment of the annual debt charge as measuring its weight. Thus the smaller proportion of the English expenditure on debt in the later, as compared with the earlier years of the nineteenth century shows so far a reduction in the burden. The relations of public outlay to national revenue and the amount of service performed by the State are both elements to be considered before this ready test can be used with any accuracy.

Finally, in estimating the weight of public debt, it is necessary to take account of the public assets that are available for its liquidation. The property employed in the discharge of the various public functions cannot be regarded in this light. The buildings and other non-revenue-yielding possessions of any government could only be sold at the cost of abandoning the discharge of normal administrative duties. Such property is an essential condition of state activity.[3] Very different is that part of public property—the *domaine privé* of French administrative law—which

[1] If we assume that the annual increase of wealth has not changed since 1885 we can add over £2,000,000,000 to Sir R. Giffen's estimate of £10,037,000,000 for that year.

[2] Cp. Prof. Nicholson's essay on 'The living capital of the United Kingdom' (*Money*, 2nd ed. 354–373), in which the highly conjectural value of £47,000,000,000 is assigned to this factor, or group of factors, of production.

[3] Cp. Bk. ii. ch. 5, § 1 for this position.

supplies revenue. Land, forests, mines, railways, and other industrial enterprises have all a market value, and would by their sale provide funds that could be employed in paying off debt. The real value of such state property is therefore fairly to be set off as a deduction from the debt before computing its capital amount, as for precisely similar reasons its annual yield must be regarded as a mitigation of the interest charge. The importance of this consideration comes out very strongly in respect to countries in the situation of the German States, the Australasian Colonies, and the Indian Empire.[1] The greater part of the debt incurred by all these countries has been for the creation of public works, which—be their value more or less than the wealth expended in their creation—are undoubtedly worth very large sums, and if in the hands of private individuals or companies would be regarded as constituents of national wealth. The real debt burden of the countries so situated is much less than the apparent one. It may even be altogether removed.

For the purposes of this allowance it is quite immaterial whether the property has been created by means of loans, or obtained in other ways. Revenue from the rent of land is as much an aid towards the payment of debt, as receipts from railways constructed by loans. The economic revenues of the State are a compensation, more or less effective, for debt expenditure.[2] It is in connexion with the original application of loans that the distinction between property obtained by their employment, and that otherwise derived comes up for consideration.

Estimates of the real weight of public debts are, it is now plain, by no means easily formed ; the considerations to be taken into account are too complex for ready and off-hand

[1] Its application in local finance will appear in Bk. v. ch. 8, § 3. The same plea is put forward by the Russian Government in mitigation of the criticisms on its growing debt.

[2] Thus the revenue obtained by the English Government from the Suez Canal shares is a deduction from the debt. The suggested debt of £30,000,000 to be placed on the Transvaal is of the same kind.

treatment. The only way of arriving at a satisfactory result is by the use of each of the different methods of calculation, and a combination of their results with the due allowances previously pointed out. Where all point in the same direction a conclusion is easily reached: where they differ the selection of the proper ones depends on the object for which the inquiry is made. If annual pressure is to be ascertained, interest is more important than capital; if the cost of redemption is wanted, capital or market value should be the primary object of investigation.

CHAPTER VI

THE FORMS OF PUBLIC DEBTS

§ 1. THE different forms that public borrowing may take affect the actual course of public debt and its development so much as to need careful notice. Nor is the method of classification quite simple. From one point of view loans have been divided into the three groups of forced or compulsory, patriotic, and voluntary business loans. The first was a favourite method with sovereigns in earlier times. Up to the reign of Charles I. it was used in England, and still later—as under Mazarin—in France. Spain and Austria have supplied more recent instances.[1] Such expedients are, however, unworthy of a well-managed State. The compulsory loan is in fact rather a tax than a credit transaction, and it may be regarded as an advance of tax revenue. Its injustice and inconvenience ought to effectually exclude it from the list of fiscal contrivances. The patriotic loan is, though for a different reason, equally inadmissible.[2] Experience shows that an appeal to national feeling is far less powerful than one addressed to self-interest. The British 'Loyalty Loan' (1796), though fully subscribed, was one of the most unsatisfactory in its results. Other countries, *e.g.* France in 1848 and Germany

[1] Leroy-Beaulieu, ii. 285–6: Roscher, § 132. For the suggestion of a forced loan by Pitt in 1796, see Sinclair, *History of Revenue*, i. 344.

[2] The British war loan of 1899 was described as a patriotic proceeding, but the subscribers were immediately able to obtain a small premium, and, therefore, self-interest sufficiently accounts for the large amount applied for.

in 1870, have altogether failed in their appeal to patriotism and for the same reasons; the Italian patriotic loan suggested in 1866 would also have certainly met the same fate. This result is not entirely due to the mastery of self-interest over other considerations in the minds of investors. For the success of a loan certain technical conditions are required. It needs the aid of the dealers in money to be successfully 'floated,' and in this respect the sentimental loan is wanting. Judged by its fruits the appeal to national feeling is a useless effort on the part of the State.

Voluntary loans issued on strict business principles are therefore the only eligible mode of procuring funds in time of need. Just as the normal agencies of supply are a more effective safeguard against scarcity than state supervision, or private benevolence, so is the system of depending on the investors' desire of a reasonable return the right one in the case of public loans. So long as good security is offered a supply of wealth will be obtainable by any State that requires it, and the most rigid application of business methods and the strictest conformity to the usages of the money market will generally prove to be the cheapest and most convenient course.

§ 2. Another kind of distinction between loans is found in the conditions on which they are contracted. The first state debts were what would now be regarded as 'floating,' *i.e.* they were advances repayable on demand. The need of keeping the funds, so advanced, for a lengthened period led to the adoption of life annuities, which in the *tontine* form were a popular method both in England and France. Under this plan the share of each deceased annuitant lapsed to the survivors, until with the death of the longest liver the whole payment ceased.[1] The issue of ordinary life annuities has also been carried on, but only as a subordinate part of the debt, and in England as a convenience rather for the annuitants than for the State.

The terminable annuity has certain advantages over the

[1] This system was named from Tonti, its inventor or populariser.

less definite plan of life payments; its exact charge can be estimated, and the time of extinction foreseen. As we saw, the annuity for a term was used as a bonus to assist in the floating of many English loans, and, later on, as a convenient way of redeeming debt. When employed as the chief mode of borrowing it has the great disadvantage of depreciating year by year, and is therefore unsuitable for permanent investment, while to the purely selfish person it offers even less attraction than a life annuity. It is only as an agent for the redemption of debt, and when used in connexion with the available capital of public departments or banking companies, that the terminable annuity becomes effective.

The modern system of issuing bonds redeemable in sections by annual drawings is a refinement on the preceding method.[1] To the State the effect is precisely the same, as it is possible, by fixing the amount redeemable in each year, to make the annual payment even all through the period of redemption, while the capitalist is sure of the principal advanced, and of interest until he receives it. Still, it introduces a gambling element into the value of the stock, and makes the suspension of redemption at any time, no matter what the pressure, a breach of faith. Borrowing may even be necessary in order to keep up the automatic process of repayment. As a means of encouraging the redemption of debt it has undoubted merits, especially when that object would otherwise be neglected; but it may prove both costly and inconvenient at times of sudden pressure.

Another modification has been employed in the United States. It is that described by Professor Adams[2] as the system of 'limited option.' Under it a minimum period is fixed before which the State cannot repay the loan, and

[1] For a comparison between the terminable annuity and the stock redeemable in sections, see Léon Say, *Les Finances de la France*, iii. 589-92. M. Say preferred the latter.

[2] *Public Debts*, 162.

also a maximum one at which the creditor can insist on repayment. During the intermediate time the State can repay at its pleasure, but the creditors cannot insist on repayment. Thus the 'ten-forty bonds' could not be paid off for ten years; they might, if convenient, be discharged at any time during the following thirty years, but become finally due when forty years have passed since the loan was contracted. The advantages of the method are that it prevents the loan being a floating one, while it fixes a limit to its existence. The time for final repayment may, however, happen to be inconvenient, and therefore such loans should be steadily reduced during the term of their optional existence.

Opposed to, and simpler than, the foregoing forms is what is known as 'perpetual' debt, *i.e.*, where the stock is issued without any date for repayment, but redeemable at any time at the pleasure of the debtor. Limits to this power of redemption may be introduced to add to the lenders' security, or in consequence of some special arrangement,[1] but the general form is as stated. On examination it appears that the real nature of the obligation is to pay a specified annuity, with the option of wiping it out by returning the original capital. Further conditions may be added which prohibit repayment for a fixed period, but this is not usual, and, when the time elapses, the ordinary form is re-established. It is in this shape that the bulk of European debts exist. England, France, Italy, the German States give instances, and a reference to the advantages of the arrangement will account for the fact.

In the first place the borrowing State is relieved from the risk of demands for repayment of capital, and has only to provide for the periodical discharge of the interest. Extraordinary expenditure is distributed into a series of smaller payments, which may be regarded as ordinary, and in consequence its pressure assumes a milder form. The

[1] Thus the present English 'consols' will not be redeemable until 1923, and the reduced 3 per cent. French *Rentes* are irredeemable up to 1910.

creditor is not, however, prevented from realising the capital value of his loan. The modern stock exchange makes the evidence of his debt a form of intangible wealth which he can always sell at the market price. This may be more or less than the original sum advanced, but it is the value of the interest claim at the time of exchange. Again, the State is always able to redeem so much of the debt as it wishes, by purchasing in the market or repaying the capital, whichever is most convenient, *i.e.* involves the smallest expense. The gradually improving credit of a prosperous country will allow of the reduction of the original rate of interest, as the threat of repayment will induce State creditors to accept the terms offered. This use of conversion, as it is called, has been already illustrated in reference both to England and France, and its service as a mode of redeeming debt will appear later on.[1] It is most easily employed in regard to the ordinary perpetual debt, which is therefore so far superior to the other kinds.

§ 3. But though the simple system of contracting debt redeemable at the debtor's pleasure is, on the whole, the best, it does not follow that the total mass of liabilities should be reduced to that shape. Life annuities, terminable annuities, debt redeemable by annual payments, are all useful forms under certain conditions. As agencies for reducing debt, or contracting certain special classes of lenders they have a real function to discharge, and it is the part of the trained practical financier to say how far each should be employed. Thus in England, the terminable annuities ought hardly to be allowed to exceed £100,000,000, as that amount is quite sufficient at any given time.[2] The French 'redeemable' debt should also be kept much below the perpetual *rentes*. The necessity of adjusting financial arrangements to the actual conditions is quite as imperative

[1] Bk. v. ch. 7, § 5.

[2] The stock held by government departments does not exceed £70,000,000, and it is by its use chiefly that annuities are created, as private persons do not regard them with favour.

with regard to borrowing as to taxation. One great advantage of the perpetual debt is its close resemblance to the stocks and shares of ordinary industrial companies. The debt paid off by periodical drawings may suit a speculative class, just as life annuities are sought by those who desire to use their disposable wealth in their lifetime. To suit loans to the taste of the market is one of the chief duties of a borrowing government.

§ 4. This function commences at the inception of a loan. Not only have its terms to be such as will draw the required amount in the cheapest way; the mode of offering it must also receive careful attention. At the commencement of the modern system of public borrowing in England, the usual course was to invite a group of capitalists to furnish the required amount, as at the creation of the Bank of England, or a list was opened to which all persons might contribute. In this way the utmost competition of capitalists was invited. The French method of confiding the business to bankers was probably less efficient. It had, however, the merit of enlisting a powerful class in its support, and making it their interest to keep up its price, as their profit, in fact, depended on the premium that they could obtain for the stock, over and above the subscription price. Where capital is not widely diffused, and where the money-market interest is powerful, this may be the best way of conciliating opposition and gaining assistance. Where a loan is not peremptorily needed, the issue of bonds at a fixed price—as close to *par* as possible—which will be gradually taken up, is convenient, while in cases of great and pressing need an appeal to the public is decidedly the best. Where this latter course is chosen, the issue may be at a fixed price, or, better still, it may be to the highest offers, with a minimum rate below which no tenders will be accepted.[1] By such an expedient competition

[1] The recent English loans for war purposes have been at a fixed discount, which increased with each issue. By this course some loss was incurred, but the money-market interest was conciliated.

brings the price up to the highest point, and those who offer the least favourable terms are not accepted. The Australasian colonies have largely employed the method of taking the highest tenders down to the price at which the loan is covered, and the same system has been applied to municipal loans in England. With the greater division of capital for investment a direct appeal to the small lender is most likely to secure satisfactory results, as it is on him that any syndicate of bankers must, in the last resort, depend.

In many cases, however, a loan is floated abroad, and then, especially if the credit of the borrowing State does not stand very high, the intervention of a group of large capitalists who will advertise the loan cannot easily be dispensed with. But in the case of a large State there ought to be no necessity for such aid. It borrows on sound security, and appeals primarily to native investors, whose subscriptions, as in the case of the French loans in 1871–2, may often be derived from their sale of foreign stocks.

§ 5. From the form and mode of issuing loans we now come to a much disputed question in this part of finance, viz. the respective merits of loans bearing high interest with small nominal capital, and loans with high nominal capital and low interest. At first sight it would appear that all loans should be contracted at *par*, or as close to it as the conditions of the market will allow. Thus, if £10,000,000 is the sum required, it is obviously better to issue £10,000,000 of 5 per cent. stock than £12,500,000 at 4 per cent. The interest charge is indeed the same in both cases, but when the time for repayment comes, the holders are entitled in the latter instance to £2,500,000 additional, unless they sell under *par*, and the prospect of converting the debt into a stock bearing low interest is pushed further off, as a 5 per cent. stock will be nearer *par* than a 4 per cent. one. The issue of a nominal capital higher than the amount actually received seems accordingly un-

justifiable, and a departure from the plain and simple course of borrowing.[1] So regarded, most of the English loans during the American and French wars would be unhesitatingly condemned, as they were borrowed in 3 per cent. stock at a price greatly under *par*. This method, which is one of the greatest blots on Pitt's financial administration, has been defended on the ground that the interest charge was reduced by it, since 3 per cent. stock commanded a relatively higher price than 4 or 5 per cent. stock. The proper proportion between them would be 60, 80, 100, but the actual one was more favourable to the 3 per cents. The explanation, of course, was that the lower stock offered a chance of gain through subsequent increase in value, which would be stopped in the case of the higher ones by conversion.[2] A further plea is that of necessity. It is said 'that Pitt had no choice. . . he had to borrow, not in accordance with his own views, but with those of the lenders.'[3] Neither defence is at all convincing. Hamilton has clearly shown that the difference in interest between the 3 and 5 per cents. was only about 9*s*. per cent., and that even this should be reduced by the advance of interest for the first year.[4] Now, such a gain is by no means enough to counterbalance the great creation of capital with its certain cost in the future. There was a small immediate saving, but on the assumption that the extra charge had been defrayed by loans, their amount would have been less than

[1] Justification may, however, exist in the fact that the gain by lower interest exceeds the loss through the creation of more capital. As Prof. Miller justly remarks (*Journal of Pol. Economy*, i. 141), 'The whole question is largely one of financial arithmetic.' The point may be illustrated by taking the opposite case of a loan bearing high interest and issued at a premium. Here the State gains in capital and loses on interest, but it is tolerably evident that the lenders will take the two sides of the transaction into account and guard themselves against loss. The great objection to the creation of extra capital is the generally improvident character of state administration, especially where future advantage is concerned.

[2] See Newmarch's paper, 'Loans raised by Mr. Pitt,' in *Statistical Journal*, xviii. 104 sq., for an ingenious defence of the policy.

[3] Lord Rosebery's *Pitt*, 210.

[4] Hamilton, 197–206.

the nominal capital added to the actual sum received. The plea of necessity is met by the existence of loans to the amount of over £60,000,000 in 5 per cent., and an £8,000,000 one in 4 per cent. stock. With sufficient determination, it is plain that far larger sums might have been obtained on the same conditions.

The real explanation of this grave error is to be found in three distinct circumstances, viz. first, the belief in the virtues of the sinking fund which led to neglect of the future course of the debt; it was expected that by a mechanical process the liability would be wiped out, no matter what its amount. Next, there was the hampering influence of the usury laws which made interest over 5 per cent. illegal, and compelled the State, for the sake of consistency, to keep within that limit. A 6 per cent. or 7 per cent. loan would have been readily taken up, and at the close of the war would have been converted into a much lower stock, as happened in the United States after 1868. Lastly, there was the natural desire to keep the debt uniform, and as the great bulk of existing obligations bore 3 per cent. interest, the new issues were modelled on their pattern and became an indistinguishable part of the general mass of consols.

The two former reasons were wholly bad; neither the sinking fund nor the usury laws contributed in this respect to the public benefit. Uniformity of stock is no doubt desirable. A large stock sells better than a small one, and there is less confusion and complication where a single rate of interest prevails. But this advantage may be too dearly purchased, as it certainly is by increasing the amount to be paid in the course of redemption. At the lowest point of credit that the English Funds touched in 1797, when the 3 per cents. were only 47, it might have taken 9 per cent. or 10 per cent. (or, perhaps, 7 per cent. irredeemable for thirty years) to get a loan at *par*, but then, as credit improved, this load, not so much greater even at first, would have been reduced, and less than half the capital sum would have sufficed for repayment.

The system of unduly increasing the nominal capital has been extensively used in France with still less excuse than the English government could offer, and with the evil result of making the capital liability much greater. Nothing but either very favourable offers for a loan under *par* at low interest, or the absolute impossibility of getting advances in any other way, can justify the procedure.

§ 6. There remain for consideration two other forms of state liability, that are both in contrast with the classes of debt previously described. These are (1) the floating debt, and (2) the issue of inconvertible paper money. The former is perhaps the oldest kind of debt, and comes into being in the most natural way. In the management of so large a business as that of the public Treasury, it must often come to pass that the payments for services or commodities will not be made at once, and that at some periods of the financial year the outgoings will exceed the revenue obtained. As a necessary consequence, either the actual persons who supplied requirements are for a time unpaid, or others advance the funds. Whichever it be, there is a temporary or floating debt. As the modern State is engaged in various business transactions, and is a lender of money to local bodies,[1] it will always have a number of outstanding accounts against it, with corresponding assets on the other side. Should there be a series of budget deficits, the floating debt will, unless it is funded, speedily accumulate to a formidable amount, as has been the case in several countries. A failure in national credit generally drives a government to increase its floating obligations, which attract less notice than the regular issue of a loan; and in all countries war or other special pressure may cause a temporary expansion of this kind of debt.

As a general principle of finance it is unquestionable that the floating debt should be kept within the narrowest limits possible. The ordinary working expenses of the administration can be covered within the year, and usually,

[1] Cp. Bk. ii. ch. 4, § 4, and Bk. v. ch. 8, § 5.

with the steady influx of the duties on commodities, in a far shorter period. The special liabilities in connexion with savings-banks, or advances to local bodies, allow of being treated as distinct accounts, and the latter can be managed by a funded debt. A growth of floating charges is at best a mark of weakness in the treatment of the state liabilities. Though it may not always be convenient to fund a mass of temporary debt, and a little delay may be admitted, this case is too exceptional to qualify the general rule.

The great evil of a floating debt is its uncertainty. To be open to the risk of a sudden demand for payment is to be in the position of a banker without the securities with which he provides himself; and it is precisely in times of commercial difficulties that the call is most likely to be made.

Among examples of unduly swollen floating debts the cases of the United States at the close of the Civil War, of England after the French War, when its amount was over £60,000,000, and of France at present, may be taken. Both England and the United States remedied their position by funding, and the same course is doubtless advisable in France. It might indeed be suggested that the floating obligations should never exceed a year's interest on the funded debt, but where the latter is very small this rule could hardly be applied, and that of keeping the temporary charges under one-fourth of the annual revenue might be substituted.[1]

§ 7 Inconvertible paper issues and their effect on economic and social life have been abundantly considered in works dealing with political economy and with monetary and currency questions. The present is no place for such topics. Here we have only to examine the use of a forced paper currency as a financial expedient. A country with a stock of the precious metals in circulation has a store

[1] The increase in the English floating debt in consequence of the great conversion of 1888 was merely temporary.

of wealth which it can obtain for use by the expedient of substituting paper for metallic money, and making it legal tender. A loan up to the value of the gold and silver in circulation is thus procured free of interest, and to a hard-pressed government this is no inconsiderable attraction. Actual and historical illustrations readily occur. England, France, the United States, Austria, Russia, Italy, not to speak of smaller States, have employed this agency, and have realised therefrom an immediate gain. The ulterior effects are not so desirable. The tendency to over-issue is too strong to be resisted, and therefore we can hardly find a case of inconvertible paper permanently keeping its nominal value. This almost inevitable depreciation involves a disturbance of the standard of value, and a nominal rise of prices that is on the whole injurious to the most important interests. Carried to a great height the issue of paper money is ruinous to national credit, while it makes the return to specie payments more difficult. At the utmost all that can be gained by the policy is the saving of the interest on a sum equal to the metals in circulation and reserve in the country, which can never be very large in proportion to the total revenue.[1] Excessive issues, on the other hand, mean a heavy tax, levied on the creditor class, and a disturbance of the tax receipts of the government, which will be in depreciated paper,[2] and immense loss to all holders, if the forced currency is not redeemed at its 'face' value, or expense to the State, if it is.

There seems to be a great body of evidence in support of M. Leroy-Beaulieu's view that the outbreak of war will in nearly every case lead to a forced currency,[3] but this does

[1] The metallic stock of the United Kingdom has been variously estimated at from £70,000,000 to £110,000,000, the interest on which would not exceed £4,000,000. In other countries the amount would be greater, but the shock to established habits would also be more felt.

[2] Governments have to accept legal tender money in payment of taxes, unless in the case of customs duties, which are often made payable in gold under the erroneous idea of drawing money into the country. Leroy-Beaulieu, ii. 692.

[3] ii. 685; cp. the statements by Viscount Goschen and Lord Avebury to the same effect. *Hansard*, April 28, 1882.

not in the slightest change our belief that such a course is both unnecessary and pernicious. The modern system of international borrowing is quite capable of supplying whatever loans may be required, and these, as already argued, need not be much in excess of what is raised by taxation. An inconvertible paper currency, if it secures a somewhat paltry gain, is, on the whole, an expensive, dangerous, and unjust form of forced loan.

In a work like the present there is no occasion for further considering the technical forms of loans, whether by inscription, by coupons, or other instruments. To keep in accord with the actual money-market system will be the aim of the prudent financier, who will naturally adopt all suitable expedients to make the stock as easily transferable and as secure as possible.

CHAPTER VII

THE REDEMPTION AND CONVERSION OF DEBT

§ 1. A STUDY of the conditions and limitations under which public borrowing is alone admissible naturally leads to the conclusion that the maintenance of a permanent debt ought to be avoided. If loans should be contracted only under great pressure, and to prevent the exhaustion of the agency of taxation, and if, while they exist, they act as a drag on the financial power of the State, it cannot be disputed that their speedy redemption must be eminently desirable. The same reasons that made taxation preferable to borrowing give support to the policy of raising taxes in order to pay off existing debt. So far as loans are derived from capital, their repayment by taxes obtained from revenue is a restoration of the wealth previously abstracted from the work of production to its earlier and more economic use. In any event the return of their wealth to the fund-holders will not diminish the economic power of the community, as some productive employment will certainly be found for it, in order to escape the loss of income that the holders must otherwise suffer. The redemption of debt is thus a mode of increasing the amount of national capital, unless on the hardly possible assumption that the whole amount of taxation raised for the purpose is drawn from capital, or in the case of a foreign loan.[1]

[1] Sir R. Giffen has declared 'that it would now be the wisest thing for us to give up any attempt at the reduction of debt, so long, at least, as the mean

§ 2. The assertion of the general position that the redemption of public debt is desirable has necessarily to be qualified by reference to the particular circumstances of each case. As it is sometimes allowable to borrow, so must it be admitted that cases may occur in which neither borrowing nor repayment is judicious. In the crisis of war, or under extra pressure of any kind, the suspension of the mechanism of repayment is obviously prescribed, and it is quite conceivable that such a state of things may long continue. The utmost that English financiers could have done during the protracted war with France was to pay the current expenses of the State, and even this, as we know, they failed to accomplish. The postponement of debt redemption is in such cases a necessity, the non-recognition of which was one of the blots in the sinking-fund theory.

On precisely similar grounds should the amount of debt to be paid off in any given year be determined. Sudden demands may make it prudent to reduce the sums devoted to this purpose, as a preferable course to the hasty increase of taxation. A review of the last forty years of English financial history supplies a series of illustrations. Exactly the same redemption of debt could not be right in such years as 1868, 1885, and 1900, when large extra expenditure was incurred, as in years like 1873 and 1889, when considerable surpluses were realised. Rapid changes in the public burdens are if possible to be avoided; indeed one of the great services of developed public credit is the assistance that it gives in escaping this evil. But here, again, there is a further influencing condition. A plan of redemption or reduction is generally organised as a permanent system, and is intended to operate through a long series of years. Suspension of an arrangement of the kind for any slight cause has a disturbing effect that is as objectionable as a small increase of taxation. To stop the normal action of

for paying are really derived from taxes on capital.' *Economic Journal*, ix. 363–4.

the English terminable annuities for a few millions' increase in expenditure would be a departure from a settled policy and a bad precedent for the future. The increase in outlay must be large in proportion to the total amount to justify such action.[1]

Debt redemption must also be affected by the position of taxation. Where inconvenient and oppressive duties are levied it may be wiser, even with a view to ultimate repayment of loans, to relieve industry and trade from their burdens and trust to the increased productiveness of the reformed system for compensation. This was the policy of Peel in 1842 and 1845, and of Gladstone in 1853 and 1860. As proved by these great examples, a thorough reform in fiscal policy may prove the best sinking fund, or, at least, its best feeder. Between the remission of very bad taxes and their retention for the redemption of debt, there is often ground for deliberation. Still, on the whole, the reasons in favour of substantial redemption preponderate. There is no hard and fast line between good and bad taxes. Every tax is so far an evil, and any one may, if raised sufficiently high, become oppressive and unproductive. Now if we hesitate to redeem debt on account of the badness of the necessary taxes, we must remember that we are thereby rendering necessary the retention in the future of worse taxes than would otherwise be required. For let us suppose the several forms of contribution to be arranged in the order of their eligibility as follows—A, B, C, D, E, F. Then the surrender of F—the worst tax—in preference to paying off debt means the prolongation of the existence of E, which, *ex hypothesi*, is worse than D, since with the disappearance of the debt the taxes appropria' to its service would also disappear. The true adjustment is therefore more complicated, and requires for its scientific solution more refined calculations than are ordinarily recognised.[2]

[1] Perhaps ten per cent. of the total amount would represent the limit within which increased expenditure should not alter the established system.

[2] Cp. Mill, *Principles*, Bk. v. ch. 7, § 2, for a statement of the cruder view.

§ 3. In the preceding section it has been taken for granted that all payment of debt is made out of surplus revenue. That, in Hamilton's words, 'the excess of revenue above expenditure is the only real sinking fund by which public debts can be discharged,'[1] is a position too evident to require formal vindication. Any valuable property possessed by the State can be employed to pay off liabilities, but only at the sacrifice of the revenue obtained from it. Both of public and private credit it is indisputably true that repayment can be made in no way except by excess of receipts over expenditure. The only possible mode by which either the individual or the State can get rid of liabilities is by making income greater than outlay. Hence in all well-organised financial systems the surplus of each year is applied for this purpose, and in the continuous action of those excess receipts lies the hope of complete redemption.

So simple and obvious a fact ought to have commanded universal assent, but the phenomena of credit have always had a remarkable tendency to create misapprehensions respecting their true character, and nowhere more than in respect to public finance. The whole history of the 'sinking fund' doctrine is an illustration of this tendency. In its earlier form the sinking fund was simply the surplus of certain parts of the public revenue set apart for the discharge of debt, and it derived all its efficacy from the excess of revenue over expenditure. But very soon the fund, from being a part of the financial mechanism, was transformed into a positive entity, and treated as if it had an independent existence. On its security fresh loans were contracted, and the absurdity of borrowing with one hand while repaying with the other, was frequently perpetrated.

The theory propounded by Dr. Price led to a new development. This writer dwelt on the great effect of compound interest. He truly calculated that a very small sum would with interest upon interest accumulate in a few centuries

[1] Hamilton, 10.

to an enormous amount. If such a principle were applied to the treatment of debt, it would, he argued, secure its speedy repayment. All that was needed was a definite capital to start with, which would increase automatically by reinvestment of the interest, until it would equal the whole debt. If to every new loan a sinking fund of moderate amount were attached, its redemption would be secured by the growth of the fund through interest.[1]

This extraordinary theory was reduced to practice in Pitt's 'Sinking Fund' of 1786, by which a special board of commissioners was created and £1,000,000 annually assigned to them for the purchase of stock, which was not to be cancelled, but allowed to accumulate, the interest being applied to fresh purchases, until each original £1,000,000 had risen to £4,000,000. Further additions were made in 1792. The surplus of that year, amounting to £400,000, and a further annual sum of £200,000 were voted to the fund; it was also provided that all future loans should have a sinking fund of one per cent. attached to them, by which they would be paid off in, at farthest, forty-five years.[2]

The pressure of war proved too much for the strict observance of this condition and various modifications were introduced, but the fundamental mistake of regarding the sinking fund as a separate and distinct source of wealth was still obstinately adhered to. From this error followed the simultaneous borrowing and redemption that were supposed to keep up public credit, but which really confused the accounts, and increased the cost of management. Purchases of stock for the sinking fund and the issue of new loans at probably lower price meant so much loss to the State. A calculation of the differences shows that the

[1] Price, *Observations on Reversionary Annuities*: criticised by Hamilton, 129–48.

[2] For Pitt's Sinking Fund, Hamilton, 97–8; Ricardo, *Works*, 517. For criticisms of it, Hamilton, 149–60; and for a more favourable view, Rosebery, *Pitt*, 81–3.

annual charge imposed by the use of the sinking fund during the period 1794-1816 was over £550,000.

So mistaken a policy could not be maintained in the face of the rational criticism, which was supplied by Hamilton and Ricardo. The true principle of regarding the surplus as the sinking fund was recognised in 1819 by the resolution of the House of Commons that a real surplus of £5,000,000 annually should be provided for the repayment of debt; but this course was not adopted owing to the bad position of the finances, and finally, after a careful inquiry, in which it was established that the method used had added £1,600,000 to the charge between 1785 and 1829, the sinking fund in 1829 was abolished as a separate institution, and the stock held for it cancelled.

The sinking fund has also been employed in the United States, where it was introduced, on Alexander Hamilton's proposal in 1790, in order to deal more effectively with the war debt. Opinions have differed as to the relation between Pitt's scheme and that of Hamilton,[1] but in any case the circumstances were widely different. Under Gallatin's administration of the Treasury the system was reformed, and his admirers claim that he anticipated the doctrine of Robert Hamilton that surplus income is the only source from which debt can be paid off.[2] The later sinking fund of 1862 has hardly operated in practice, as owing to the large surpluses more debt was redeemed than the sinking fund provisions contemplated.

From the foregoing facts it is evident that a sinking fund can be useful only in so far as it is based on a surplus of revenue over outlay, and, therefore, the belief in its efficacy rested on a fiction. Its sole advantage consisted in the pressure that it brought to bear on the finance minister to

[1] See Adams, *Public Debts*, 265; Ross, *Sinking Funds*, 51–3 Dunbar, *Quarterly Journal of Economics*, iii. 46–54.

[2] 'There is disclosed in the administration of Mr. Gallatin the true policy of debt payment. . . Under the guidance of his clear insight this country departed from the pernicious methods of English financiering.' Adams, 268. Cp. Ross, 60.

supply the requisite funds, while 'its operations are scarcely perceptible to a public, justly if sometimes ignorantly impatient of taxation.'[1] The effect was in practice to keep the surplus at a higher point than it would otherwise have reached, and to prevent the reductions of revenue, which as, subsequent experience amply proves, were certain to be demanded. But this benefit was too dearly purchased by the extra cost, and was always exposed to the risk of being swallowed up by fresh loans.

§ 4. The modern methods of redemption are all founded on the necessity of providing surplus revenue for the purpose; while at the same time they endeavour to secure the stability of the sinking fund, by ear-marking a special sum to be used in repayment. Such is the idea common to the new English Sinking Fund, by which a specified sum is annually devoted to discharge of debt, to the 'terminable annuities,' and to the 'redeemable' debt as it exists in France. Under all these systems there is a determination of part of the revenue to the purpose of repayment, which, if steadily persisted in, will extinguish the liabilities, unless the relief so obtained is used for fresh loans.

The chief difficulty in the way of debt discharge arises from the carelessness or positive dislike of the great body of the taxpayers in respect to the adoption of vigorous measures for its attainment. The simple and straightforward policy of appropriating a large surplus, maintained expressly for the purpose, to the useful function of reducing the public liabilities is not regarded by them with approval. Unless surrounded by some rather complicated financial arrangement, which disguises the true nature of the process, the surplus is apt to be frittered away in expenditure, or to disappear by reductions of taxation. The redemption of the English debt after 1829 suffered in this way, and nothing but very exceptional circumstances could have brought about the great repayments of the United States debt after 1866.

[1] Lord Rosebery, *Pitt*, 83.

Nevertheless it is perfectly evident that the redemption of debt must sooner or later be faced. If in times of peace and low expenditure no surplus is raised, and if borrowing is freely resorted to whenever exceptional demands occur, then the proposition previously quoted from Hamilton [1] will certainly be applicable, and the debt will ultimately 'amount to a magnitude which the nation is unable to bear.' Insistence on this fundamental point is the duty of the wise financier who regards the future as well as the present, and is concerned for the continuous prosperity of his country. The extent to which taxation should be carried for this purpose, and the particular arrangements adopted, must necessarily be varied, but the general principle always holds good.

An additional advantage of debt redemption should also be noted. All repayment tends to raise the credit of the State and to improve the basis for possible future loans. A real sinking fund—*i.e.* one based on an actual surplus—keeps up the price of stock, though a fictitious one does not.[2] Each portion of debt withdrawn from the market reduces the amount available for investors, and though this cannot alter the permanent conditions affecting interest, it yet improves the character of the particular stock. Where the debt is below par, redemption by purchase at the market rate steadily brings it up to that point, when a new agency can be brought into operation.

§ 5. This is the process known as 'conversion,' by which a stock bearing a given rate of interest is altered or 'converted' into one at a lower rate. We have seen several examples of its use in England, France, and the United States,[3] from the first conversion of 1716 down to the recent English conversion in 1888 and the equally successful

[1] Bk. v. ch. 5, § 4.

[2] The very high price of English Consols in the period 1894–9 was mainly due to their purchase by the National Debt Commissioners, operating in a limited market. See Giffen, 'Consols in a Great War,' *Economic Journal*, ix. 353 sq.

[3] Bk. v. chs. 3 and 4 *passim*.

French one in 1894. The principle is very simple, and is applicable to both public and private credit. A landlord who has a mortgage on his estate on which he pays 5 per cent. will naturally, if he can borrow the amount at 4 per cent., give the mortgagee the option of taking 4 per cent. instead of 5 per cent., or of repayment of the principal. Loanable capital, like other commodities, will be sought on the cheapest terms, and conversion is only an example of the general tendency. Indeed, we may go further, and say that, where it is practicable, there is a duty imposed on the finance minister, who is the agent of the taxpayers and bound to consult their interest, to carry out a scheme of conversion on the best terms. Such a view does not, however, commend itself to the fundholders, and where they form a numerous class very strong opposition to any measure of the kind may be expected.[1]

As the method of conversion can only be effectively applied when stock is over par, it requires as a condition precedent a good state of public credit. Punctual payment of interest, adequate provision for debt redemption, and prudent administration generally will all assist in this work. It need hardly be added that the higher the original rate of borrowing the greater room there is for the employment of this agency, a fact which we found to be one of the strongest arguments against the creation of a higher nominal capital than that really borrowed, but bearing low interest.[2]

Certain plain general rules hold good with reference to this part of finance. First, the capital of the debt should not be increased, unless for a sufficient consideration, as it amounts to an addition to the future burden. English conversions have for the most part been free from this mistake, but the offer in 1883 of £108 of 2½ per cents. for

[1] In France, for example, conversion has not for this reason been attempted at certain favourable periods, viz. (1) under the Orleanist governments, and (2) between 1878 and 1883.

[2] Bk. v. ch. 6, § 5.

£100 3 per cents. was a doubtful step. Some of the French conversions, notably that of 1862, were tainted by it. Next, it is desirable to make the scheme simple and free from complicated stipulations, in order that it may be readily understood. A direct reduction of interest, with, perhaps, a guarantee against further conversion for a period, is on the whole the best. The fundholders will not of their own accord accept any plan of reduction; the motive power comes from the capital available elsewhere, and therefore the plainer the offer, the better is its chance of acceptance. Thirdly, it is well to choose the time for the operation carefully. The commencement of the period of returning prosperity that usually comes some years after a commercial crisis is the most suitable. Loanable capital is then abundant, and the rate of interest is low, so that the chances of succeeding are at their highest. Fourthly, there is an advantage in using the conversion to consolidate stock of different kinds, as has been accomplished in several English cases;[1] but this consideration should not be carried too far, as it may be essential to separate stocks bearing the same interest, but issued on different terms, and in any case the operation will deal with that part of the debt that bears the highest interest.

The funds set free by conversion are of course available either for the remission of taxation or for further redemption. It seems, however, that the latter use is the preferable one. Gains from skilful management of the debt are in justice to be credited to it, and their application in this way is, unless in exceptional cases, to be recommended. The retention of the fixed debt charge at £28,000,000 would have brought the present English provisions for repayment nearer to the position they should occupy.

§ 6. Among the plans proposed for getting rid of a national debt, that of a general contribution by the holders of property has commanded most support. Ricardo

[1] Those of 1716, 1751, and 1888 are examples. The conversion of the French 3½ per cents. is another good instance.

declares that 'a country would act wisely by ransoming itself, at the sacrifice of any portion of its property which might be necessary to redeem its debt,' and Mill allows that this course 'would be incomparably the best, if it were practicable.'[1] The objections are, however, overwhelmingly strong. The method would place the whole burden on property-holders, as earnings could not contribute to the extent that would in fairness be required. But all property is not equally disposable, and some of it will at any given time be almost incapable of realisation. As a consequence this class of wealth would be sacrified, or its owners compelled to borrow on far more onerous terms than the State has to pay. In fact, the same arguments that prove the necessity of borrowing at times of pressure also prove the impossibility, or at all events the great inexpediency, of wiping out debt by a general contribution.

The use of capital in investments at a higher rate of interest has also been suggested as a mode of creating a surplus. Such a method really involves the action of the State as a capitalist, the danger of which appeared in connexion with the economic receipts,[2] and, in any event, it is rather a mode of increasing state income than a simple means of debt redemption. If the policy be justifiable, it is so quite apart from the existence of public liabilities, and it should be judged on its own merits.

§ 7. It has often been pointed out that, altogether independent of the agencies already noticed, there are certain normal forces in operation which tend to diminish the pressure of debt, and which will, in the future, make its redemption easier. The progress of society, so much relied on by Macaulay, adds to the national wealth, and makes a public debt, that once seemed formidable, of comparatively little importance. The progress of Great Britain in the last century would have reduced the debt charge as it stood in 1791 to a very small part of the present public revenue.

[1] Ricardo, *Works*, 149; Mill, *Principles*, Bk. v. ch. 7, § 2.
[2] Bk. ii. ch 4, § 1.

Other countries show the same phenomenon, and therefore there is some apparent force in the argument that the redemption of debt should be postponed to a more seasonable opportunity. In a country like the United States the steady increase of national wealth is sure to make the debt burden much lighter as time passes on.

But though this fact undoubtedly deserves recognition, it hardly supports the inference drawn from it. The repayment of debt is not a weakening of national power, nor ought it to be a severe pressure on the existing members of the society. Its amount should be kept within the bounds set by the extent of suitable taxation which would not press heavily on any class of taxpayers. The reduction of debt is, moreover, an effective aid to public credit, and by its progress affords the means for reducing taxation. Again, as each period has its own charges to meet, the neglect of repayment will make the future burden at least equal to the increased resources. Such a policy is a dangerous discounting of the future, and the tendency to adopt it is one of the worst symptoms in modern finance. There is, it must be added, no sure ground for concluding that economic progress will continue indefinitely. Many possible causes, some of them in action at present, might bring it to a standstill. Jevons has familiarised us with the idea that England's prosperity depends on her coal supply, which must at some time be exhausted.[1] This relation of industrial expansion to the possession of certain material agents points to the necessity of taking careful account of the potential extent of these conditions of progress before allowing the accumulation of debt. We cannot foresee the precise line of economic change, but it is well to err on the side of safety, and provide for the liquidation of existing liabilities within a reasonable period.

Another supposed alleviation of the pressure of state debts has been discovered in the progressive depreciation of money or, in other words, a change in the standard of value.

[1] This important question is again exciting public interest.

That the Australian and Californian gold discoveries had, among other consequences, the effect of making the real weight of public debts lighter is evident enough. All depreciation favours the debtor at the creditor's expense, but so does appreciation give the latter a like advantage. The mention of this possibility shows the weakness of the position of those who look to monetary depreciation as a source of relief. For the last twenty years the weight of debt has been increasing, and we cannot say whether in the distant future the standard of value will rise or fall, so that no satisfactory conclusion can be based on its probable movement. But even on the assumption that depreciation will ultimately take place, it does not follow that the State will gain. Is it not likely that lenders will hesitate to make advances on a depreciating security, unless they receive compensation in higher interest for the risk they run?[1] There is in addition the objection that to count on this change is really to speculate on a defect in the standard of value. Neither on grounds of fact nor of equity can we regard the relief of the state debt through depreciation as well established or desirable.

§ 8. The distinction drawn between home and foreign loans and the error of exaggerating its importance have been previously noticed. In connexion with repayment it has been said that a public loan held by foreigners is, when productively applied, an augmentation of the country's capital, and that its redemption is not desirable. Not to dwell again on the fact that the boundary between inland and foreign loans is not very easily determined, it may be remarked that the service of a loan consists in its application, not in the existence of the obligation. The advances made to the Australian colonies for railways were of service by allowing those agencies of transport to be

[1] This statement is in accordance with Prof. Irving Fisher's theory that appreciation of money tends to lower interest. See his *Appreciation and Interest*; also Prof. Clarke's articles, *Political Science Quarterly*, x. 389 sq., xi. 249 sq., 493 sq.; and Marshall, *Principles* (3rd ed.), 673-4.

speedily built, for which purpose the continuance of the debt is not needed. The real question at issue is rather between the use of state funds for redemption, or for fresh production, or again between raising loans to pay off debt, and leaving that wealth in the possession of the citizens. To settle this question the rate of interest and the probable effect of the other courses open must be duly considered. When gains are high the continuance of a loan at a low rate of interest may be expedient, but effective provision for repayment is the best mode of securing loans at a low rate.

CHAPTER VIII

LOCAL INDEBTEDNESS

§ 1. THE rapid increase in the debts of local governing bodies has been noted in an earlier chapter as likely to give rise to serious financial difficulties in the future. A national debt, whatever be its evils, is open and conspicuous ; it is under the control of the government of the whole people, and is based on the total wealth of the country. It, moreover, has usually been incurred for objects of general interest, the ultimate value of which can be measured, and its treatment can be effected by public opinion guided by judicious criticism. In all these respects local indebtedness is less favourably placed. Instead of the single State, there are many bodies of very different character and importance, and with altogether diverse requirements. Each distinct administration borrows on the security of its special revenue, which may be adversely affected by local conditions. The expenditure of the innumerable loans is very hard to follow, and intelligent criticism is almost wholly wanting. Sectional interests and ignorance of financial principles have the same influence on borrowing that they have on taxation and expenditure: they tend to lower the probability of obtaining either economy or just distribution. Under such circumstances it is the more important to examine the chief features of the system of

local borrowing that has spread so widely in the last fifty years.

§ 2. As regards the fact of increase, there is the most positive and convincing evidence. In 1875 the local debt of England and Wales was £92,000,000. Six years later it came to £144,000,000. By 1888 the total was £192,000,000. In 1891 it had become £201,000,000, while in 1899 it had risen to £276,000,000, showing for the period of twenty-four years an annual increase of over £7,600,000. This general growth is made up of special increases, which in such an instance as that of London are very striking. The metropolitan debt, which was only £21,000,000 in 1875, touched on £51,000,000 in 1899, showing a steady advance in the last twenty-five years.

The Irish and Scotch local debts, though insignificant in comparison with those of the English towns, are also becoming greater, and are now over £50,000,000.

Other countries show the same tendency. The debt of the French *communes* (excluding Paris) has risen from £13,600,000 in 1862 to nearly £23,000,000 in 1869, and to £30,300,000 in 1878. In 1891 it exceeded £54,000,000; at the end of 1900 it was £59,670,000. The Parisian debt is by itself a formidable sum. In 1870 it was £59,000,000. In March 1890 the various debts of the French capital were £75,000,000, and at the close of 1900 they were £94,350,000.

Many of the Italian *communes* are also increasing their debts. At the close of 1896 the total due by them was over £48,000,000, though this amount was small compared with the debt of the central government.

A great development of local (and particularly urban) debt is also to be found in the United States. As Professor Adams has pointed out,[1] the great creation of municipal debts was after the opening of the Civil War. He estimates the total indebtedness of the smaller divisions in 1860 at $100,000,000, of which over one half was due by towns having over 7,500 inhabitants. Ten years later (1870)

[1] *Public Debts*, 343 sq.

this liability came to $515,800,000, in 1880 it had further increased to $822,100,000, while in 1890 it had grown to $906,200,000.[1]

§ 3. The causes of this general movement are not difficult to trace. Local, like national, borrowing is dependent on the existence of favouring conditions; and these are to be found, first in the greater power conceded to local bodies, or rather in the extension of their administrative functions during the 19th century. Another cause is the far larger amount of disposable wealth seeking investment, and the natural desire of its holders to get good security, and this is undoubtedly afforded by most public bodies. Thirdly, the needs of city life call for the creation of works involving much capital outlay. Drainage, water-supply, lighting and transport agencies, have, at the lowest, a semi-public character, that has led to their being in many instances placed under the suitable regulative body, which had to employ its credit in order to procure the required funds. It is in this last respect that local and national debts present the greatest contrast, though some of the latter have been created in the same way.[2] Defenders of the modern system of local borrowing point to the valuable estate formed by its use. Waterworks, gasworks, tramway lines, and market buildings may all be looked on as sources of revenue, which, after meeting their liabilities, will in some cases give a surplus for other objects. The element of truth contained in this mode of regarding debt has been already considered, but it is here desirable to indicate the

[1] The following table shows the comparative indebtedness of the several divisions in 1880 and 1890 respectively:—

	1880.	1890.
States	$297,244,095	$228,997,389
Counties	124,105,027	145,048,045
Municipalities ...	684,348,843	724,463,060
School Districts ...	17,580,682	36,701,948

It thus appears that state indebtedness is declining, but that of the smaller divisions is increasing, though this advance has been checked in recent years by legislative restrictions.

[2] Prussia, Austria-Hungary, Russia, India, and the Australasian colonies may be given as instances.

qualifications to which it is subject. Granting the superiority of 'reproductive' over 'unproductive' debt, it does not follow that the former is in itself desirable. That public property, if revenue-yielding, is an asset to be set off against liability has been already explained. Whether either item should be preserved in the financial system is a distinct and separate question. Thus the various municipal industries are obviously a great aid in meeting the local debt charge, which, however, except for them would hardly have existed. The real point at issue is the expediency, socially, economically, and financially, of the conduct of such industries by public authorities. If public is superior to private management, a financial gain may be looked for, though it by no means holds good that all profitable industries should be taken up by the public powers.[1]

There are some further considerations which tend to limit the use of borrowing for this purpose. The loan system involves the interposition of the credit of a public body between the lender of capital and the actual investment. Whether gas or water works be economically successful or not, the interest on the debt incurred for them has to be met. Such investment may prove to be profitable, but, on the other hand, it may be unsuccessful, and in the latter case the burden falls on the contributors to the particular revenue affected. It is in this undertaking of risk that the borrowing system appears to show its weakest side. Speculation is a task altogether unfit for public bodies.[2] In another way the local revenue may suffer. The absorption of a class of industries into the public property reduces the amount of private wealth available for taxation, and it is quite possible that the loss in this way may exceed the supposed gain on the working of the industries. The burden of proof rests on those who favour the process of forming a municipal domain, and they are bound

[1] Cp. Bk. i. ch. 1, § 2 for the limitation of public activity in this respect.

[2] This is the really crucial point in connexion with the vexed question of municipal trading.

to establish (1) the strong probability that the community runs no financial risk, and (2) the superiority of their method to all alternative ones. The control of special industries, as indicated when considering the industrial domain,[1] is a less pretentious but in many cases a more effective method.

§ 4. But though the policy of using public credit in a systematic way for the establishment of profit-giving industries should not be hastily adopted, and, if attempted, should be kept within comparatively narrow limits, there nevertheless remains a legitimate field for local borrowing. The needs of any modern community are such as to make increased expenditure unavoidable, and that expenditure is largely devoted to the supply of educational, sanitary, and social requirements. Schoolhouses, baths, drainage, libraries, and museums have to be provided by heavy immediate outlay, and as under the circumstances they cannot directly yield a revenue, it falls within the province of the public power to take them in hand.[2] The economic conditions impose the necessity of getting such works done quickly, as otherwise the earlier expenditure would be for a long time useless. Loans are accordingly the only available means ; for taxation must be kept within bounds, so as not to swell up the net revenue of a single year. The burden is by this contrivance distributed over the time during which the works are of service, or at least over a fairly long period.

A great deal of modern local debt has been incurred for such objects, some of which, *e.g.* waterworks, pass imperceptibly into the strictly reproductive part of local expenditure. In the case of London, for example, almost the whole of its liabilities has been so created. Paris in like manner borrowed for the 'improvements' of the

[1] Either by special taxation or the sale of concessions, Bk. ii. ch. 3, § 6.

[2] Even on the assumption that Adam Smith's ideas as to the limits of state action should be observed, 'The duty of erecting and maintaining certain public works' is one of those prescribed by him. *Wealth of Nations*, 286.

second Empire, and to repair the damage of the war of 1870–1.

This process of anticipating revenue has greater justification in the case of a local than in that of the central government. The former deals with a smaller revenue, on which any extraordinary outlay will have greater effect, and it is restricted in its taxing powers, while the national government can more easily distribute its outlay from year to year, and possesses full control over its means of revenue. As a general rule, therefore, it is true that loans are a convenient, indeed an indispensable, part of the financial machinery of the smaller bodies.

§ 5. The forms or classes of local borrowing may next be considered, and here also its difference from that of the State is noteworthy. The absence of sovereign power brings the town or district more nearly on a level with the industrial or trading company, while its necessary subordination to the central government makes control and regulation by the latter expedient. Just as local expenditure and taxation need the watchful care, and at times the restraining hand, of the sovereign,[1] so does local borrowing. There is, besides, a financial benefit in the interposition of state credit to assist the smaller subdivisions. Local loans, therefore, fall into two classes, viz. (1) those raised directly by the borrowers, and (2) those obtained by advances from the State. The former until recently gave evidence of the undeveloped character of local credit. Mortgage loans or floating obligations were the usual forms. Now, however, the funding system is making rapid way, and nearly every important town has its consolidated stock, modelled on the type of the national debt. Corporation stocks form a distinct class of securities in the money market, and command a good price. This higher organisation has the great advantages of procuring loans on better terms, and of bringing the amount of borrowing before the public. So long as the debt of a

[1] For expenditure and taxation, cp. Bk. i. ch. 7, § 7, and Bk. iii, ch. 6, § 8.

town or district is broken up into several separate kinds its real amount is hard to ascertain, and it may be increased without attracting notice.

Local stock is sometimes redeemable by annual drawings (like the French 3 per cents.), or, more often, it is automatically worked off by a sinking fund, the established method in the second class of loans—those provided by the instrumentality of the State. For very small divisions the issue of separate stock would be impossible, and any ordinary loan could only be obtained at a high rate of interest. The central government can, without inconvenience, make advances in such cases, and arrange for repayment by instalments at suitable times. In Great Britain the Treasury acts as the intermediary, and makes the advances from capital, which is really a part of the national debt.[1] Belgium also has a special fund for this purpose, and in Germany the fund for invalids—one of the assets of the Imperial treasury—has lent more than £10,000,000 to the *Gemeinden*. The convenience of thus providing local bodies with advances on reasonable terms is very great, while at the same time it enables the central government to exercise effective supervision over the borrowing so conducted.

§ 6. Repayment of local debt has to be regulated in accordance with its general features. As it is generally incurred for objects that are useful, or at least assumed to be so, the time of redemption ought to be adjusted to the duration of the utility created. Some improvements are much more speedily exhausted than others, and it cannot be well to have a debt charge which represents no present benefit. Again, local debt does not ordinarily arise from any pressing emergency. Its use is rather to get the work quickly completed, and therefore a sinking fund that will remove the charge within a definite number of years is often serviceable, since at the conclusion of the term new objects of outlay can be dealt with in the same way. The

[1] The separation of the local debt carried out by Lord Goschen marks this very clearly.

larger bodies may prefer the issue of stock, redeemable in parts or by annual sections, or even take the chance of further reductions of interest, and the power of conversion thence arising.[1] The danger of this course lies in the possible neglect of the necessary provisions for repayment, and in the undue accumulation of debt. A sinking fund that makes repayment compulsory has decided advantages. A difficult question, however, arises in connexion with the determination of the proper period for redemption. If it is very short the immediate taxpayers suffer, while their successors in after years are free from the burden. When a longer time is fixed the pressure may fall chiefly on those who hold leases extending over the time, leaving the benefit to a reversioner who has perhaps contributed nothing to the payment of the charge.[2] This failure in just distribution is, however, primarily a question of taxation. We have seen that local charges should be distributed on different grounds from those that regulate general taxation,[3] and that the chief reasons for making this distinction are the predominance of the economic element in local expenditure, and the necessity of taking the several interests benefited into account. The use of loans enables a just distribution to be more closely attained, since future interests come under liability as they are realised. But at the same time their service in this respect must be subordinate to their general working. Direct taxation of reversionary property may also be desirable, though this course is limited by serious difficulties. A still better way of reaching justice is to maintain a steady policy with regard to expenditure. By so dividing outlay as to keep it in a nearly constant proportion to the rateable value of the wealth liable, it is clear that in the great bulk of cases the partition of charges between holders of property at different times will not be an unjust one, though some exceptional instances may

[1] Many of the larger British towns are favourably situated for this purpose.

[2] Cp. Fawcett, *Political Economy*, 629–31.

[3] Cp. Bk. iii. ch. 6, § 5.

occur. Very heavy and irregular expenditure by means of loans will be almost certain to cause serious practical grievances, which would, however, also be found if taxation were employed in the same way.

§ 7. Up to the present our attention has been chiefly directed to the urban and smaller rural divisions, and they are no doubt the most important. But the indebtedness of intermediate bodies, such as the English Counties, the French Departments, the Prussian and Italian Provinces, and on a higher scale the German and American States, deserves some notice. Special conditions have prevented the counties in the United Kingdom from coming forward as borrowers.[1] A different reason has closed the loan market to the American States, but there are general causes for the smaller development of provincial borrowing. The works of utility for which local debt has been incurred are for the most part confined to small areas, or are of national importance. They fall either into the hands of the State or into those of the *commune*. The duties of the province are such as can, generally speaking, be met out of revenue.

It would, however, be going too far to conclude that there will be no expansion of this kind of public debt in the future.[2] In relation more particularly to transport, there is an opportunity for creating or purchasing railway lines or canals of secondary importance, as in other instances there may be one for an extension of public forests. The German States show an example of the former which is also found to a smaller extent in the French Departments. Arterial drainage or reclamation of waste land might also be carried out in the same way, and the loans for such objects should be governed by the same principles as those applicable to municipal debts. So much depends on the future course

[1] The County Councils will probably in the future make greater use of their borrowing powers.

[2] It is quite possible that the 'intermediate' bodies (cp. Bk. i. ch. 7, § 5) will grow in relative importance. See Prof. Marshall's suggestions in *Memoranda, &c.* [c. 9528], 123-4.

of political movement that no prediction is possible; but for finance it is sufficient to dwell on the necessity of applying the same rigid tests to all classes of borrowing, and to insist on the danger of its undue use.

§ 8. The great importance of adequate control by the central government has been already indicated, but it is desirable to again lay emphasis on the point. If expenditure and taxation cannot be safely trusted to administrators who may be led astray by ignorance and prejudice, still less can the power of mortgaging the property of those under their rule. For this reason rigid supervision is exercised in most countries. Local bodies in the United Kingdom can borrow only by a special legislative act, or after a semi-judicial inquiry by officials of the State. In France authorisation is in like manner needed for communal and departmental loans. The American State constitutions often place limits on both State and municipal borrowing powers, and the latter are also regulated by the State legislatures. The convenience, indeed the necessity of some method of the kind is obvious; without it a numerical majority of the inhabitants of a district, perhaps possessing little monetary interest in its future condition, could burden all the holders of property and future residents with a load of debt. Heavy taxation soon brings a remedy in the impatience of the taxpayers; but borrowing is, for the time, an agreeable process whose evils are only perceived later on. Thus the creation, the amount, and the mode of repayment of debt all stand in need of due regulation by the supreme authority of the State. The method employed will of course vary with the particular circumstances, but it seems best to reduce the system to a set of general rules, limiting the amount obtained to a certain proportion of the taxable value,[1] requiring definite reasons for the issue of each distinct loan, and providing for a sinking fund, or other effective means of repayment, within no very distant time. These con-

[1] Two years' valuation is the limit in British and Irish towns.

ditions are all insisted on by the English Local Government Board, and they seem to be necessary for the protection of those concerned. A direct appeal to the central legislature is the proper way of dealing with exceptional cases when they arise.

The character and scale of the particular bodies concerned should, further, be taken into account. Temporary loans by a large city, repayable on demand or within a short period, must be soon met out of taxation, and they may be allowed under the same rules as those controlling the taxing power. There is no need for the same constant check as that essential in the case of small areas.

This power of regulation and its efficient exercise show the real unity of all public liabilities. Whether contracted by the State or by local administrations, they result from the use of the credit obtained through public property and the power of taxation. Their examination, therefore, must be conducted on the same principles, and their effects must be combined to form a proper estimate of the true financial position of the country.

BOOK VI

FINANCIAL ADMINISTRATION AND CONTROL

CHAPTER I

INTRODUCTORY—HISTORICAL DEVELOPMENT

§ 1. We recognised at the commencement of our inquiry that problems of administration and control form an integral part of the science of finance. It is not sufficient to consider public revenue and expenditure with the relation that exists between them. The constitutional guarantees for the proper application of outlay and the due and moderate levy of taxes, the machinery by which those processes are effectively carried out, and, finally, the agencies by which, and the manner in which, the public accounts are prepared and verified, have important effects on both income and outlay, which need to be studied if we want to understand thoroughly the nature and working of public economy. To the discussions of the preceding books we have to add one on 'Budgetary Legislation' in the widest use of the term.[1]

So long as financial topics were regarded as a part of applied political economy, there was some excuse for omitting to notice matters that seemed rather to belong to the

[1] The literature for this part of the subject has received important additions since the last edition of this work. Stourm's valuable treatise is now in its 4th edition and is paralleled by the German work of Heckel, *Das Budget*. Masè-Dari's *Bilancio dello Stato*, is specially useful for Italy. A fuller recognition of the necessity for studying budgetary legislation as a part of finance is evidenced in the space—one-fifth of the whole treatise—allotted to it in Adam's *Science of Finance*, and the smaller works of Plehn and Daniels also devote separate sections to this topic.

domain of public law. But when we treat them as forming a distinct branch of political science, this reason loses all plausibility. At the same time it must be said that we are not directly concerned with constitutional or administrative principles and details. Legal and political conditions are of importance only in so far as they produce financial effects, and need be considered only from that particular point of view. Their more elaborate and thorough investigation must be left to the jurist or political philosopher.

§ 2. It is instructive to note that this side of public economy, though often neglected by modern writers, was the part of finance that first attracted the attention of students and practical administrators. The most important part of the financial system to those engaged in its working is the machinery by which the various state requirements are duly met, while to the contributor, the authority that taxes him, the way in which it uses its powers, and the checks on its action are the really vital matters.[1]

The modes of financial regulation, like the forms of expenditure and revenue have been gradually developed in the progress of society. It is unnecessary to repeat the account already given of the primitive stage in which little special regulation is requisite. The sentiment of the tribe, or, later on, of the ruler, is the all-sufficient authority for outlay or contribution. Careful official organisation and refined constitutional rules would, under such conditions, be as impossible as any of the other expedients of higher social life, *e.g.* the credit, or railway system, or modern constitutional government. To this earliest form succeeds the period in which the domain is the chief source of public revenue, as in the city States of Greece and Italy, and also in feudal Europe; and here the whole financial mechanism is not very different from that of any private economy. State or royal officers collect rent and administer the public property placed under their care by the

[1] For the attitude in this respect of the mediæval writers, the Germans of the seventeenth century, and Montesquien, cp. *Intr.* ch. 2, §§ 3, 5.

methods usual at the time. Receipts are thus directly applied to meet the public wants according to the ruler's discretion. Along with this economic or quasi-private revenue may be placed the beginning of indirect taxation. The various services rendered by the ruler afford a ground for indefinite exactions, and his prerogative rights, which can easily be stretched beyond their due limits, are enforced by his servants.

When public economy has progressed thus far, methods of account and control make their appearance. The Roman Treasury was under the charge of the *Quæstors*, but complete unity of system did not exist, and it seems to have been the *Censors* who acted as finance ministers under the direction of the Senate. Even in the time of the Empire there was a separation between the distinct treasuries of the State and the *Princeps*, though the course of movement was towards fusion, and the official organisation for the collection and control of revenue was minutely subdivided and graded. The method of farming out the taxes on commodities and inheritances must also be regarded as a further mark of that incompleteness of system which was inherent in the ancient state economy.

Mediæval kingdoms, and such smaller bodies as the free cities were likewise forced to devise means for the due regulation of their income and expenditure. Thus methods, at first rude and imperfect, were gradually improved. The English Exchequer, with its curious and picturesque forms, was an agency of this kind, to which the King's debtors had to account, and his creditors to apply for payment.[1] The Carolingian Empire had its check on accounts, as the rules of the Capitularies show, a system continued under the Capetiens, but essentially of the nature of a private economy.[2]

[1] See the *Dialogus de Scaccario* (attributed to Richard, Bishop of London), printed by Madox in his *History of the Exchequer*; also by Stubbs, *Select Charters*, 168–248. Hall's *Antiquities of the Exchequer* gives a more popular account of the working of the system.

[2] See Bouchard, *Système Financier*, 21 sq., on this point.

A striking characteristic of this stage is the rare and infrequent use of direct taxation. It only appears as an occasional and extraordinary resource reserved for times of emergency, and quite distinct in its nature from either the economic revenue or the dues (*Auflagen*) on commodities. The importance of this circumstance in the present connexion arises from the need of the contributors' assent to legalise the employment of direct levies. However cut down and reduced in later times, it was the common law of the feudal State that direct taxation required the consent of the classes who had to pay it.

§ 3. The growth of the monarchical power from the preceding condition was gradual, and is illustrated by the history, both of the later Roman Empire and of the several European countries in the 15th and 16th centuries. The collection of revenue came more and more to assume the aspect of a public function; the ministry of finance was recognised as a government department, and the methods of control and accounting were further improved. This special progress is bound up with the whole course of political development, and can be fully explained only by reference to the actual historical conditions. The increase of royal authority, the greater cost incurred in the performance of public tasks, and the more frequent use of money in transactions, conjoined in giving higher importance to financial administration.

One consequence of the increasing centralisation of government was the inclusion of such smaller public economies as the cities and minor districts in the state organisation. The resulting absorption—total or partial—of their revenues had the natural effect of making the need for full accountability on the part of those engaged in collecting or expending public funds still more pressing. The loss of popular liberties, and the absence of due control on accounts, explain the oppression and waste that usually mark the financial practice of absolute governments. When the salutary check imposed by the opinion of the

contributors is removed, it is vain to expect the observance of those maxims of prudence embodied in the canons of taxation, nor can we expect a proper supervision of the many items of expenditure.[1]

The secrecy in respect to public revenue and expenditure that was formerly so noticeable, and which has been dispelled by the extension of constitutional government, had extremely evil effects. On the one hand, prodigality and injustice often escaped notice, while, as an aggravation, fair and legitimate taxation and expense were through ignorance frequently regarded as grievances. Publicity and responsibility have been proved by a lengthened experience to be the necessary conditions for an efficient administration of finance. Though every country that has any semblance of a settled government must possess some of the constituents of a financial administration, and though it is possible as in the case of the Roman Empire to have a highly developed system of taxation and expenditure managed by an extensive official class, without any check on the ruler's will, yet the probability of prudent management and due adaptation to the special conditions is extremely small. Sound finance is so bound up with good government that one cannot be had without the other. Observance of the technical rules of public economy might indeed be carried out by a body of trained administrators under an absolute monarch, but unless the checks provided by the full publication of authentic accounts and the indirect influence of public opinion in some shape or other are in operation, it seems hopeless to expect it.[2]

§ 4. The rise of constitutional arrangements in respect to financial matters undoubtedly originated in England,

[1] Cp. Bk. iii. ch. 7. The condition of the French finances just before the Revolution affords an admirable illustration of this statement.

[2] The case of France under the *Ancien Régime* referred to in the preceding note is also instructive in regard to the evils that result from concealment and the absence of responsibility. At present the Russian and Indian finances show by their contrast the advantage that publication of vouched accounts and the power of opinion may be, even to a subject country.

and therefore it may be said that in their present form the guarantees for proper administration are the result of her example, extensively imitated during the past century by other countries. We find the principle that grants to the Crown should be voluntarily made by the Estates of the Realm definitely established in the 14th century, as also the right of inquisition into the application of the funds so provided.[1] But the events of the 15th and 16th centuries practically destroyed this older system of parliamentary control, which had to be reconquered from the Stuarts. The issues of the Civil War were closely connected with the right of taxation, and even on the Restoration the supplies to Charles II. were determined by the Parliament. Votes for particular purposes—*e.g.* that for the navy—were limited to the amount deemed requisite in each case, though this restraint was in fact easily evaded. But the rudimentary character of financial control is very apparent during this period.

The Revolution of 1688 made parliamentary supervision and control a reality. By the expedient of an annual Appropriation Act, limiting and defining the purposes of expenditure, and the amount to be devoted to each, it became impossible, without directly breaking the law, to use the public funds in any way other than those sanctioned by Parliament. The establishment of cabinet government, with the inevitably resulting dependence of the executive on the legislature, brought the details of financial management before the Lower House, which had already asserted its superiority to the Upper one in respect to money bills.[2] The annual financial statement known as 'the Budget' thus arose, and the many intricate rules as to the legislative conduct of financial business were developed as occasion needed.

[1] Hallam, *Middle Ages*, iii. 84–86; Stubbs, *Const. History*, ii. 543–601. For the development of parliamentary taxation see Gneist, *History of the English Constitution* (2nd ed.), 388–93.

[2] Hallam, *Const. History*, iii. 27–32

The preparation of the materials, and the final checks on the accounts, were, as we shall see, added subsequently, and will probably undergo further change, but it is here sufficient to remark that the growth of British financial legislation and control has been quite indigenous, and in full harmony with the general movement that has made the law of the constitution so peculiarly flexible and capable of being adjusted to new conditions. Budgetary regulations are really a mass of laws and conventions in which the latter are perhaps the more important.[1]

§ 5. Other countries have followed the example of England, and the rules that in her case have been left elastic, and supported only by the sanction of public opinion, have hardened into the rigid provisions of a written constitution. To find the neatest expression in strict legal form of the code that governs the conduct of finance at home, we have to refer to the legislation of France, Italy, and Belgium, though of course there are variations due to peculiarities of constitutional development.

Historically, this remarkable result began with the revolt of the American colonies. The right of taxation was the actual cause of dispute,[2] and the establishment of American independence involved the complete control of the representatives over the national finances, a privilege expressly provided for in the existing Constitution[3] and hedged round by effective guarantees.

In France the Constituent Assembly at once asserted the principle that no taxes were legal except those voted by the delegates of the nation, but it did not extend the

[1] Dicey, *Law of the Constitution*, 328–9. See, for a fuller account of the actual regulations, Anson, *Law and Custom of the Constitution*, ii. ch. 7.

[2] In the colonial period there had been frequent disputes with the governors as to the granting of supplies and the preparing of estimates.

[3] 'The Congress shall have the power to lay and collect taxes.' Art. i. § 6. 'All bills for raising revenue shall originate in the House of Representatives.' *Ib.* § 7. 'No money shall be drawn from the Treasury but in consequence of appropriations made by law; and a regular statement and account of the receipts and the expenditures of all public money shall be published from time to time.' *Ib.* § 9.

control of the popular will to the equally important matter of expenditure. As M. Stourm has shown,[1] this task was reserved for the Restoration period, and indeed it is naturally later in order. The prevention of illegal exactions is a far more urgent work than that of securing a perfectly correct application of the supplies voted for the public service, and it is besides much easier to deal with. The rapid growth of constitutional government has brought the question of financial control into greater notice, and the general result has been a fuller recognition of the essential principles of popular consent and administrative responsibility, as they have been developed in England. The very bitterness of the disputes on these points—specially illustrated in Prussia[2]—proves the tendency towards their more complete establishment.

The formation of a thorough system of audit and account is one of the latest steps in the attainment of a good financial organisation. In respect to it England has not held the same leading position. The system in use on the Continent is rather French than English in its forms and methods, and has moreover a judicial instead of an administrative character.[3] Institutions of the kind have to be judged by their fruits, a test which after all may be endured without fear by the present English methods, imperfect as they may seem when abstracted from the particular instance in which they are employed. A final characteristic of modern finance in this department is the partial co-ordination of general and local income and outlay. Social and economic conditions have contributed to this centralising movement, by which the scattered elements of local finance are collected and compared with those of the State. The necessity for bringing the checks of a wider public opinion and the restraining power of the central government to bear on local action is a further reason. Careful audit and strict observance of the technical conditions

[1] *Le Budget*, 40 sq. [2] Stourm, *op. cit.* 23–5.
[3] Cp. Bk. vi. ch. 3, § 7, for further explanation.

desirable in any body of accounts are now regarded as indispensable in the regulation of the finances of the minor political bodies, and their natural result is to be seen in a closer relation of central and local finance.

§ 6. The preceding historical notice was requisite in order to understand the actual condition of financial method and regulation in the civilised nations of the present day. Though the varieties that still exist are by no means unimportant, either in themselves or as evidences of the differences in political development that have produced them, there is sufficient uniformity to allow of a description which will hold true generally, and the departures from which will also admit of classification and explanation. In the succeeding chapters these general features will be concisely examined.

CHAPTER II

THE BUDGET—ITS PREPARATION—THE COLLECTION OF REVENUE

§ 1. FINANCIAL processes are necessarily recurrent; from the initial steps for the provision of funds to the final closing of transactions certain proceedings are required that must be repeated on every similar occasion. We may, by taking an instance of each and combining them, bring together the several stages of a financial period, and thus study the operation of modern public economy on one of its most important sides. Such a study will naturally commence with a notice of the preparations for what is known as the Budget.

This term, first applied in England to the annual financial statement,[1] has in other countries and in theoretic discussion come to mean the financial arrangements of a given period, with the usual implication that they have been submitted to the legislature for approval. There is therefore a combination of the ideas of (1) a valuation of receipts and expenditure, or a public balance-sheet, and (2) a legislative act establishing and authorising certain kinds and amounts of expenditure and taxation.[2] The convenience of the term as including the several steps of financial legislation

[1] Derived from the French *bougette*, the bag in which the minister carried the papers and accounts necessary for his statement. The term seems to have come into use about 1760. Dowell, ii. 139.

[2] For the scientific use of the term 'Budget' see Stourm's excellent work *Le Budget*, 1–5.

and control is so great that it is in that wider sense that we shall use it.

§ 2. The first requisite in the formation of a budget is an approximately correct idea of the expenditure within the period to be considered. In order to combine efficient legislative control with regularity in payment for services and commodities, it is necessary that this estimation shall take place beforehand. Accordingly in the modern State we find that the several departments of administration have to frame what are known in England as their 'Estimates' some time previous to the opening of the budgetary period. The particular mechanism and division will vary in each country, but in all the general process must exist.[1]

The task of bringing together the scattered elements of outlay devolves on the Ministry of Finance, and the head of this department has in most countries an indefinite power of control over the expenditure. It is always open to him to remonstrate against, or at least to comment on, what appears to be extravagant outlay, and in the fullest development of this power lies a useful safeguard for economical administration. The control exercised by the Treasury in England over the spending departments, though often unpopular, is yet in this respect of the utmost value. The necessity for giving a plausible reason for every new item of expense is a hindrance to new and unnecessary claims that keeps within limits the natural tendency to increase, and checks the waste so common in public economy. Its chief defect lies in the fact that it has not sufficient expert advice and accordingly offers an indiscriminate opposition to all expenditure, prudent or the reverse. But this defect, specially prominent in time of war, is hardly avoidable under present conditions.

English methods are probably more effective than those of other countries. In France, the system of control hardly exists, while in the United States the division of authority and the influence of the Committees of Congress hinder

[1] Stourm, *op. cit.* ch. 3.

effectual supervision.[1] Still, even in those countries a finance minister with sufficient courage and determination has been able to exercise a salutary influence, as the cases of Sully, Colbert and Villèle, as also those of Hamilton and Gallatin, prove. The close connexion of the several divisions of the financial system, on which we have often laid stress, is very clearly seen in this part of the subject. Prudent reduction of outlay is quite as effective as skilful adjustment of resources.

Nevertheless, it is in dealing with the latter side of the national account that the financier's function is supposed to specially consist. It lies with him to say what under the given circumstances will be the receipts available to meet the estimated expenditure, and if there be an absence of equilibrium to suggest the best mode of restoring it. For the probable yield of existing taxes, and the receipts from the domain in its various forms, the Minister of Finance is dependent on his advisers, who direct each branch, but it is essentially his duty to propose such alterations as may seem proper, and the more definite his responsibility is made, the better is the prospect of efficient management. The creation of the budget is therefore a work of administrative art, in which the use of proper methods will very materially improve the financial position, and contribute to the public advantage.

§ 3. A number of questions naturally arise in respect to the regulation of this initial stage of action. We have spoken of the budget as covering the several financial processes of a period, but we may say that in practice this rather vague term means a year. The convenience of taking stock of the public income and expenditure, and the fact that ordinary outlay is usually repeated every year, but not oftener, as well as the recurrence of the principal physical and economic conditions in the same time, contribute to bring about this result. Even where legislative sanction is not annually sought,[2] the accounts are

[1] Stourm, 74; Wilson, *Congressional Government*, 171–2

[2] As in some of the smaller German States.

separately stated for each year. A longer term would conceal the real variations: a shorter one would fail to eliminate accidental changes and the effect of special circumstances.

But though the yearly period is always selected, there is no agreement as to the date of its commencement. Various dates (January 1st in France, Belgium, and Austria; April 1st in England, Germany, and Denmark; July 1st in Italy, Spain, the United States, and Canada) have been chosen for the opening. The reason that has determined the adoption of these different dates is financial convenience. If the English finance year coincided with the civil one (as it did up to 1854), the budget would have to be presented either long before, or some time after, the opening of the period; but the former would make accurate calculation of receipts and expenditure almost impossible; the latter would compel expenditure without Parliamentary sanction or a recourse to 'votes on account.' The French budget has generally to be prepared 'fourteen or fifteen months before the period of its execution,'[1] to the detriment both of its accuracy and unity. What particular date shall be taken in each country can only be settled by reference to its legislative and administrative habits, but the aim of bringing preparation and execution as close as possible to each other should be the guide, and this accounts for the selection of different dates in different nations.

More important than the particular period are the form in which the budget is presented and the matter to be contained in it. Due arrangement and classification of the several chapters, or, in English phrase, 'the votes,' will make the nature and movement of expenditure much more intelligible, and also strengthen the constitutional check that the legislature possesses. A grouping by the several ministerial departments—good so far as it goes—does

[1] Stourm, 77. The alteration of the French financial year has been often suggested. See the discussion of the matter by Léon Say, *Finances de la France*, iii. 315–59.

not suffice; the English division into 'consolidated fund' and 'supply' services, with the subdivision of the latter into 'Army,' 'Navy,' and 'Civil Service' votes, is not full enough, while the further breaking up into 'votes,' which may be for 'millions' or for 'thousands,' is too detailed, and is open to sudden changes which vitiate comparison. Either is, however, superior to the separate 'appropriations' of the American system, which hinder a clear presentation of the annual expenses as a whole, and therefore make effective criticism impossible.

Next to the proper arrangement of the many heads of outlay comes the question whether the total amounts, or merely the balances of the various expenses and receipts, shall be presented, or, in technical language, whether the budget shall be a 'gross' or a 'net' one. The latter is the earlier and in some respects the more natural method. In a great spending department, such as the Army, it would seem that any trifling gains should be treated as deductions from the sum of expense, with which alone the nation is really concerned. In like manner the cost of working the Post Office might seem immaterial in a financial point of view, so long as the net gain remains unaltered, a statement that is equally true of the Inland Revenue and the Customs. There is, too, the further difficulty that with an extensive state domain the presentation of the gross figures gives, as already noticed, an exaggerated idea of both expenditure and income.[1] The Prussian or the Indian budget presents a very different appearance, according as the gross or net items are taken into account. But this notwithstanding, the 'gross' system is, on the whole, better, inasmuch as it brings all financial details under direct review. In the spending departments it prevents irregularities in disposing of public property, and in dealing with the funds so obtained; or, at the worst, it gives opportunity for bringing them to light. Again, in regard to the earning departments, it is well to have their cost of working care-

[1] Cp. Bk. ii. ch. 5, § 5.

fully watched. The expense incurred in collecting taxation is a form of outlay that may be much reduced by suitable arrangements, and the introduction of a thorough control over it is a decided improvement. Even in the industrial departments of the State a like vigilance will prove useful. If the English Treasury sometimes keeps too tight a hand on the Post Office, its supervision removes the occasion of many scandals, though in such cases the recognition of something more than the purely financial aspect of the business should, as in the parallel instances of the Army and Navy, be secured by the concession of powers of remonstrance to the minister in charge of it.[1]

§ 4. Of somewhat the same character is the dispute as to the separation of the budget into distinct parts. In an undeveloped financial system the usual course was to assign a special receipt to meet each special charge. Thus the term 'ship money' explains the original purpose of the charge, and the 'hereditary excise' was designed to provide for the King's expenses. As the public economy advanced, this separation was seen to cause inconvenient complications. Some accounts had surpluses, others deficits, and their combination into a 'consolidated fund' supplied a remedy for this want of balance. Compensation and elimination of chance influences were better attained by the fusion.

Recently the system of special budgets for particular kinds of expenditure has been somewhat widely employed, though it is an expedient evidently calculated to confuse the public accounts, and to prevent the true situation of the finances being understood. The general rule of meeting expenditure out of income should be openly transgressed only by the use of a loan. A surplus on the ordinary

[1] It seems plain that the head of a great industrial department, such as the English Post Office has become, should have the same weight as the heads of the Army and Admiralty admittedly possess. The difficulty of applying the strict administrative control necessary in the case of public expenditure to industrial undertakings is one very weighty argument against extension of the state domain. The Treasury could hardly keep a Railway Department within bounds.

budget, with a deficit on one or more extraordinary ones, is a direct infraction of the principle that the finance accounts should be submitted fully, simply, and in unity.[1]

Another point of some delicacy is the determination of the precise items to be included in a given budget. Starting with the intention of giving the receipts and expenses of a particular year, we may either take the actual incomings and outgoings of the Exchequer, or we may endeavour to assign to the year under notice all the revenue, whenever received, that properly belongs to it, and charge against it all expenditure incurred in it, though perhaps not paid till a much later time. In the former or English method there is a simplicity and directness that commends itself to any one who realises the benefit of those qualities in finance, while the latter appears to have the advantage of giving a more precise account of the real result of the transactions of the period at the sacrifice of a good deal of delay. This part of the subject more fitly belongs to a later chapter, but here we must note the greater difficulty of estimating under the French system, though it again has not much substantial effect.[2]

Lastly, there is the problem of deciding on the proper method of estimating the expenses and receipts of the approaching year. On the correctness of these estimates rests, in a great degree, the success of the budget, and no parliamentary majorities, or use of official power, can alter the hard facts of finance. Sincerity and care are both needed for success in this operation. One very natural course is to take the figures of the immediately preceding or some earlier year, generally the last for which the accounts were made up, as the basis. Another method nearly as

[1] The French method of adding smaller budgets to the ordinary one is therefore a violation of principle and injurious in practice. Stourm, 187. It may, however, be said that the *Budget sur Ressources spéciales* is really a statement of one part of local finance. But it is incomplete as regards the *communes*, and in fact of no service as a mode of control.

[2] The respective merits of the French *compte d'exercice* and the English *compte par gestion* are carefully considered by Stourm (ch. 5), who is perhaps too favourable to the former.

mechanical is to take the increases during preceding years and count on a like result in the future. In reality these facts should only be regarded as elements in the calculation. The revenue and expenditure of a State do not move in a definite course; they are acted on by many distinct causes, and it is on these that the financier should frame his estimates. In dealing with expenditure the statements of the several departments concerned are the starting point, but it may happen that their requirements will prove more costly than they themselves admit, a consideration that should not be overlooked. Still, the results of experience and the great extent of the modern public economy make valuation easier than it was; special emergencies apart, expenditure is well within the field of rational prevision.[1] The receipts present greater variations within the ordinary limits, though they are not subject to the great sudden changes that expenditure may show. Agricultural and industrial prosperity or adversity will leave their mark on the revenue returns. The elasticity of certain taxes has been already noticed, and the public income as a whole is sometimes liable to fluctuate. The task of estimation is therefore a work that cannot be reduced to any automatic rule. The circumstances of each country, and each particular year, have to be examined on their merits. In this respect the modern development of statistics has been a most efficient auxiliary. The financier of the present day has at his disposal materials that were unknown to his mediæval, or even eighteenth-century, predecessor. Population, banking, shipping, agricultural, and industrial statistics, together with the criticisms to which they are subjected, are available as aids in forming a judgment on the probable course of the facts material to the growth of revenue, and as these technical instruments improve we may expect even greater accuracy in the future.

[1] The estimates of expenditure in England for the three years April 1, 1889, to March 31, 1892, as compared with results, show an error of only £137,000 in a total of £264,000,000, or a little over 1*s.* per £100.

§ 5. The several processes just described are essential preliminaries to a due presentation of the budget for the consideration of the national representatives. This legislative examination and approval, however important or even vital in the modern constitutional State, is nevertheless, as we saw in the last chapter, a late addition to the financial mechanism, and therefore, before considering it, we shall deal with the more general machinery by which the public revenue is brought into the Exchequer. At first the contributions in kind were delivered directly to the leader of the tribe, who also collected the economic receipts, such as they were. The State, as its organisation gradually developed, dealt with its taxes on the private or 'contract' system. Thus both in Greece and Rome the great mass of the public revenue was collected by farmers, or paid in directly by the dependent cities as tribute. This method, so characteristic of an ill-managed economy, continued in regard to the Roman indirect taxes to the last, and was revived in the absolutist monarchies of the sixteenth and seventeenth centuries. The other mode, viz. that of apportioning taxation to the several cities or districts, is evidently due to the establishment of contributions after conquest, and it also is an inheritance from an earlier stage.

The use of direct taxation and the increasing power of the State brought the special tax officials into more prominence. At first the supervisors of the state domain collected whatever taxes were not let out by contract. In England this duty fell to the sheriff, who, however, often obtained his office by purchase; the count discharged the same function in the Carolingian Empire. But the great source of a special official organisation is found in the customs revenue, which was more peculiarly in the King's hands. The unfortunate policy of letting out the indirect taxes was widely adhered to, as *e.g.* in France, where the *Fermiers généraux* were a power in the State. The older system of separate and privileged districts and towns continued to a great extent up to the end of the eighteenth

century, so that many public levies were apportioned among the contributing groups, to be afterwards subdivided between the members of each. The farming of taxes and the method of apportionment are the most decisive marks of an imperfect fiscal system. The former puts the payment of taxes on the same footing as a private debt, while the latter interposes a distinct authority between the citizen and the State. It is not necessary here to dwell on the grievances that the farming out of revenue has produced. The Roman 'publican' and the French '*fermier*' were both proverbial instances of rapacity, and the loss to the revenue was only exceeded by the sufferings of the poorer contributors. Apportioned taxes are plainly inelastic in yield, and are generally defective in distribution. Both are, however, justifiable under certain conditions. Where tax-collectors are easily corrupted and organisation is backward, farming may be the only way of making duties productive, and of meeting the expenses of collection. In like manner it is expedient to adopt the apportioned tax, where the statistical *data* for correct assessment are wanting, or where evasion is a serious danger.[1]

The recognition of the relative use of these more primitive forms does not in the least show that the collection of revenue by public officials, for the benefit solely of the public powers, is not now the right one. Fiscal practice supports this view. Every modern government has its customs department for that branch of revenue, while the internal receipts are obtained by one or more official agencies. In England the Inland Revenue Department has absorbed the several Boards that preceded it, but the Post Office necessarily preserves a separate existence. Three different departments collect the French internal revenue under the heads of direct, indirect, and stamp duties, the public industries being also separately dealt with. The Prussian finance department undertakes the main work of revenue collection, but the Ministries

[1] Cp. Wagner, ii. 747.

of Agriculture and Public Works have the management of the quasi-private receipts.

In all countries, however, the tax-system must at last come in contact with the individual citizen, and it is very prudent to make this unpleasant relation as little irksome as possible. Hence have originated Adam Smith's rules as to the 'certainty' and 'convenience' of taxation,[1] as also the very general preference shown by administrators for indirect taxation, since by it the number of persons dealt with is reduced to a more manageable figure. Where direct taxation is largely used, the local authorities or their officials may be utilised for the purpose of collection, but it appears that, on the whole, central management is more effective, though the same person may conveniently be the agent of both administrations. Simplicity and rapid action are not the most conspicuous qualities of 'self-government,' but they are those most needed in the collection of revenue.

§ 6. The actual process by which the funds find their way from the taxpayer's pocket to the central treasury of the State must depend on the economic condition of the society. In earlier times contributions in kind would be moved by the collectors to the places where they were needed. Taxes paid in money have to be brought to the public treasure-house, and stored up for future use. The development of credit enables the whole proceeding to be carried out by the agency of banks. Thus the old English Treasury has been superseded by the Bank of England, into which the receipts flow from the various points of collection. The French system of 'sub-treasuries,' keeping separate accounts and transmitting their surpluses, either in coin or by the aid of the Bank of France, is more complicated and costly. There can be no doubt that centralisation, not merely of the staff but of the receipts, so easily accomplished by the aid of credit, is the best course. Backward countries must, however, make use of branch

[1] See as to these rules Bk. iii. ch. 7.

treasuries, and provide for the storing of coin at convenient points in order to reduce the expenses of its transmission;[1] but whatever be the treatment of the actual material of revenue, its combination in the public accounts into a single body to be dealt with at the pleasure of the sovereign is one of the processes needful for the establishment of a proper budget.

[1] The system adopted in India, where 266 district treasuries are established. By the use of bills the transmission of funds, so far from being an expense, is made to yield a slight profit.

CHAPTER III

THE VOTE OF THE BUDGET—CONTROL AND AUDIT

§ 1. THE first stage in the life-history of the budget is finished when the administration has laid its proposals before the legislature. It is highly desirable that the scheme of finance so presented should possess the several qualities indicated in the preceding chapter, which may be concisely summed up as consisting in economy, timeliness, intelligibility, completeness, unity, and accuracy. In other words, the estimates of expenditure should be carefully framed, and kept down to the smallest amount consistent with efficiency ; the period dealt with should be that about to commence ; the arrangement and grouping of the items should be logical and easily followed ; the full amounts to be received and expended, not merely the probable balances, should appear ; the several sections should be brought together and treated as a whole ; while the valuations should be real, and based on the best evidence attainable.

But though the observance of these rules will materially assist the deliberations of the chambers, they will not of themselves suffice to secure a good result. The parliamentary treatment of the budget, which apparently belongs to the subject of public, and especially constitutional, law and usage, has important financial bearings. The method by which expenses and taxes are voted will often account for the good or bad working of a particular system, since the checks imposed on governmental action may either be

insufficient, or too severe, as, on the other hand, the legislature may be too careless, or unduly active, in regulating financial matters.

§ 2. The consideration of the budget is one of the principal tasks of a legislative session. It involves the study of a great number of detailed points which must occupy a good deal of time, and in certain cases may give rise to keen political controversy. The way in which it is approached will have something to do with the merits of the final result. In most countries the ministerial estimates are submitted to preliminary examination by a committee supposed to be specially suited for the work, and this body reports on—in effect very often recasts—the proposals of the executive. The United States system goes the farthest in this direction by placing the initiative in the hands of distinct committees. Financial measures, in fact, come from the legislature itself, though they are partly conditioned by the requirements of the public departments. The necessary consequence is the loss of all unity of plan, and a failure in almost every year to even approach equilibrium.[1] England is in the other extreme: the 'estimates' and the proposed annual taxes are placed at once before the whole House sitting as a committee, and examined without any previous inquiry.[2] Ministerial responsibility is thereby increased, as the measures that make up the *ensemble* of the budget are altogether the work of the Cabinet, whose liability is undivided. The committees of Continental countries, though they appear to secure fuller deliberation, are really a screen for the original preparers of the financial proposals, and divide that liability which should be definitely fastened on the administration.

[1] Wilson, *Congressional Government*, ch. 3.

[2] M. Stourm supposes that the attendance in Committee of Supply is smaller than in the case of ordinary sittings. *Le Budget*, 273. He has been followed by Masé-Dari (*Bilancio*, 112) and Adams (*Finance*, 147–8). The latter asserts that 'as a matter of fact none but the leaders commonly attend.' This view is altogether erroneous.

Another peculiarity of the English system goes far to explain its strictness as to outlay, viz. the ancient rule that all proposals for expenditure must come from the Crown, *i.e.* at present from the Ministry. No addition can be made to the estimates submitted, and anything that even indirectly violates this rule is opposed to the stricter constitutional doctrine.[1] All expenditure therefore originates with those who have an evident interest in keeping it within bounds, as they will have to propose the taxation required to meet it. A stronger check on the natural tendency towards increased expenditure could hardly be devised, and it is at once curious and characteristic that it should be the result of a now departed condition of things.[2]

The evil effect of the absence of such a rule is seen in the increased expenditure often proposed by the French Commission on the budget, and also in the Australian colonies, where, though the limitation exists, it is evaded.[3] It is particularly noticeable in the United States, where members of Congress are more interested in securing expenditure desired by their constituents than in maintaining the due balance of the national finances, and therefore indulge in the operation known as 'log-rolling,' in which representatives agree to support each other's schemes.

§ 3. Serious constitutional disputes have arisen respecting the rights of the different chambers with respect to the budget, which, however, seem to have very little financial importance. Usage in England has given to the Commons what is practically the sole power in this department, but in other countries the Upper House retains the right to reject or amend financial legislation, and the

[1] Todd, *Parliamentary Government in England*, i. 690 sq.

[2] 'This principle is commonly involved in mediæval metaphysics as to the prerogative of the Crown, but it is as useful in the nineteenth century as in the fourteenth, and rests on as sure a principle.' Bagehot, *English Constitution*, 146.

[3] Hearn, *Government of England*, 378. Cp. Leroy-Beaulieu, ii. 113.

American Senate avails itself extensively of this privilege, chiefly in the direction of increasing the appropriations of 'the House' for the public service. Regarded as a question of *technique*, it would seem that if the two Houses are to consider the budget, the discussion should be a joint one, as otherwise the work of detailed examination has to be done twice over, and unless there is some restraining rule, the ultimate outcome will be greater confusion and less conformity to any settled plan. If the legislative authority of the second chamber must be recognised, it may best be secured by confining its action to the laws necessary for sanctioning the budget, leaving the examination of the separate items to the popular chamber where they are first presented.

But whether the discussion be principally conducted in one House or separately carried on in each, the grouping of the several heads to be considered deserves attention. In this respect the general course of progress has been towards greater specialisation. From the early period in which the supplies were voted *en masse*, to be applied at the ruler's will to the public services, we have come to a time in which the separate heads may be numbered by hundreds. Thus the French budget, which in 1831 had only 164 chapters, has been steadily subdivided until that for 1890 has come to contain 807 ; and since 1831 each chapter has been separately voted.[1] The English Civil Service 'votes' have at times reached 150, to which must be added the smaller number for the army and navy. A thorough sifting and rearrangement, especially of the former, would be a great improvement.[2] The votes for each civil department might be taken in a group, with further discussion of the leading items by a grand committee. No large assembly can possibly control each of the branches with effect,

[1] Stourm, 295. In the United States the separate appropriations amount to about two thousand.

[2] In 1900 the votes were rearranged by the government, but the opposition at once objected to the change.

though its criticisms on the larger heads may be most useful. It is even possible that each group of votes might be thoroughly examined by a separate committee, and afterwards discussed on general grounds in the House.[1]

From the method of separate votes or chapters, together with the principle of legislative control, follows the rule that no transfer can take place from one vote to another. A surplus on the votes for justice cannot be transferred to meet a deficit on those for education, or *vice versâ*. Moreover, in England each of the Civil Service votes is separate and cannot be transferred, while those for the army or navy may be used for other votes in the same department, subject to re-examination in the next budget. As the votes for these departments are few in number, and the total amount is usually very nearly spent, the possibilities of excessive outlay under this rule are not great. By a better arrangement the same method could, if needed, be applied in other departments, but rigid limitation to the amount voted under each head is doubtless a check on useless expenditure.[2] A reserve fund to be employed only on the responsibility of the government, and to be replaced in the next financial period, is perhaps a better arrangement, as it draws more attention to over-expenditure.[3]

§ 4. The difficulty of exact adjustment and the occasional necessity for meeting unexpected demands tend to impair that unity of the budget which is one of its good qualities. In the actual arrangement of so complicated an organisation as that of any modern State, mistakes in calculation and sudden calls that no prudence could anticipate will from time to time occur. English usage has provided the

[1] The 'committees' of the American system have this advantage, but in their case there is no real unity.

[2] It has, however, been pointed out that this limitation may lead to extravagance by inducing a department to spend rather than surrender surplus funds. The official feeling is 'let us use up our balance.'

[3] As in the case of the two English funds of the 'Treasury Chest' and 'Civil Contingencies.'

agency of 'supplementary estimates,' by which additional amounts are voted to meet the extra requirements. This process, which has been made more frequent by the prompt closing of each year's accounts and the stoppage of transfers, is nevertheless, according to competent opinion, 'one of the greatest financial evils.' 'To render parliamentary control effectual it is necessary that the House of Commons should have the money transactions of the year presented to it in one mass and in one account.'[1] A system of applying for frequent additional votes would completely destroy the single budget, or at least deprive it of any value. This expedient should therefore be confined within the narrowest limits consistent with efficiency, and such is the established English policy.

In some cases, however, the amount required may exceed the funds at the disposal of the government or be wholly indefinite, as in the case of actual or threatened war, when the recognised expedient is a 'vote of credit,' which amounts to an authorisation of expenditure, and secures the control of Parliament, though it breaks the unity of the budget, but in the least dangerous way. The technical rules of financial management ought to be sufficiently flexible to meet such emergencies, and a special vote at once satisfies this condition, while it indicates that the proceeding is irregular and exceptional.

In other countries a like restraint has not been observed. 'As regularly as the annual session opens there is a Deficiency Bill to be considered' is what we hear from the United States.[2] The additional credits in France for the seven years 1879–85 came to £66,200,000, or, deducting savings on other heads, to £43,400,000, an average net excess of £6,200,000.[3] Belgium, Prussia, and Italy, under the form of a qualifying budget, also transgress the normal

[1] Gladstone, quoted by Todd, *Parliamentary Government*, i. 740–2.

[2] Wilson, *Congressional Government*, 159. Prof. Adams approves, though with hesitation, of deficiency bills as a necessity. *Finance*, 184–5.

[3] Stourm, 369–73. His figures do not quite agree with those given by Leroy-Beaulieu, ii. 104.

bounds of additional votes. It would seem as if a long constitutional discipline were needed to secure due attention to this point, as well as a proper budgetary system. The unity of the budget may apparently be infringed in another way. It might seem that all the expenditure and revenue should be annually voted in order to preserve complete legislative control. In fact, however, this course is neither necessary nor desirable. So long as a substantial part of the outlay is subject to the discretion of Parliament, and the mode of paying out the funds is under strict legal arrangement, there is no danger in making permanent provision for the greater bulk of the public demands.[1] Certain heads of expenditure—particularly the interest on debt, and the salaries of the judiciary—are best removed from the field of party disputes. The general revenue system will not be annually changed, and it can be most conveniently fixed by permanent legislation. Such is the *rationale* of the English 'Consolidated Fund,' into which by far the largest part of the revenue comes by virtue of permanent Acts, and out of which one-third of the annual expenditure is drawn by the same authority.

This distinction between 'permanent' and 'annual' outlay and income is useful in more ways than one. It reduces the already too heavy work of voting supplies, which might indeed be further reduced by placing all absolutely needful expenditure on the Consolidated Fund. It also helps to separate the stable from the movable taxes. The income-tax performs, as we have more than once stated, a useful function in supplying unexpected demands, and it is therefore rightly an annual tax of varying amount. So, too, are some of the customs, *e.g.* the tea duty. The separation between the two classes of taxes might be even

[1] The proper mode of providing for increased naval expenditure has been a subject of hot debate between the two great English parties. Lord Goschen preferred the permanent method; Sir W. Harcourt advocated the annual one. So long as a consistent scheme is adopted and maintained there seems to be really no important difference. The control of the House of Commons over expenditure is in either case effective.

more strongly emphasised, though the position of the income-tax is probably sufficient for the purpose. There is, besides, an advantage in retaining the greater part of the public expenditure under the annual scrutiny of Parliament, so that until an item is unquestionable, and its amount very definitely settled, it should not be transferred to the 'Consolidated Fund' charges.

For a very different reason German military expenditure is voted for a period of seven years, and is therefore removed from annual debate, by which arrangement the Imperial Government is relieved from dependence on the *Reichstag*. Some of the smaller German States have biennial or even (as in Hesse) triennial budgets, an impossible system in any country with active constitutional life, and one which will be abandoned as the popular element becomes stronger.

The permanent settlement of some sections of income and expenditure does not really infringe on the principle of unity. For England the annual financial statement—'the Budget' in the English sense—brings together all the heads of expense and receipt, as well as the movement of national debt. The Consolidated Fund charges are definitely known, and 'the Estimates' supply information as to the remaining expenditure. The votes in committee either of 'supply' or 'ways and means' give the basis for the budgetary legislation of the year, which is in a sense supplementary to the existing laws, and, combined with them, makes up 'the budget' in the wider use of the term.[1]

In other countries the adoption of the English system has led to greater formal strictness and stronger emphasis on 'the law of the Budget.' Convention and usage have,

[1] Thus the tedious process of 'supply,' which used to take thirty-five working days of the session, is, in the French sense, a part of the budget. By the existing rules of the House of Commons twenty days are set apart for supply, and on the last of these days all the votes that remain are put to the vote without debate. This has the effect of unduly extending discussion on the earlier and destroying it on the later votes.

however, been on the whole more successful in keeping up a high standard than definite constitutional enactments, as a comparison of English with Continental finance will amply prove.

§ 5. The general efficiency of English management is largely due to a feature of its budgetary system already referred to—viz. that which prescribes the closing of accounts at the end of each financial year. Only the actual money paid out is included in the expenses: all balances on votes lapse on each 31st of March, and if required, must be voted afresh. Only the taxes actually received are credited to the year, unpaid arrears going to the next budget. The system secures an accuracy and facility in dealing with the accounts which make their presentation soon after the close of each year a feasible measure. The consequence is that in his financial statement the Chancellor of the Exchequer is able to deal with the results of the year just closed or closing, and the prospects of the opening one. The position of the finances is distinctly known, and no need for amended returns can arise.

The French method, in which the financial year is invested with a kind of personality, and its arrears of receipt and expense come to its account at any later time, has an appearance of completeness, since it assigns to a given period all the consequences due to it. Delays in collecting taxes or postponement of expenditure may affect the English accounts,[1] but by separating to each year what is really to be attributed to it this danger is avoided. On the other hand, there is the fatal objection of delay. To make criticism valuable it must be speedy. The French

[1] Peel, for example, miscalculated the yield of the income-tax for 1842 by not taking into account the fact that only one half of the tax would come in during the financial year. Northcote, *Financial Policy*, 41. Lowe increased some of his surpluses by manipulating the collection of the income-tax. More generally, there is no doubt that a surplus could be manufactured by starving the permanent part of the public services and throwing the additional cost of replacement on succeeding years.

budget of 1880 could hardly excite much interest in March, 1883—the date of the presentation of the final law relating to it—when the Chamber was more interested in that of 1884, which had been just laid before it for the first time. It is hopeless to expect that long past transactions will be carefully examined, and therefore the adoption of a quick, even if less precise, method is preferable. But even the superior accuracy of the French system is somewhat doubtful. The arrears both of outlay and income will normally be about the same from one year to another, so that what is lost at the opening will be made up at the close. Besides, it must be remembered that the arrears are at best a small part of the total amounts.[1] To gain somewhat greater precision in the small balance of a small proportion, the whole mass of accounts is surrounded by the obscurity that lapse of time must produce. Accordingly we are not surprised to find that Germany has on this point followed English rather than French example. Italy, while adopting the English method, has supplemented it by a further account of the normal position of the national finances.[2]

Professor Adams, who has carefully investigated this point, makes the important suggestion that the French system is an imperfect attempt to realise the principle of accruals, which is, he remarks, used in 'the best corporation accounting.' Instead of considering the mere cash receipts and expenditures, liabilities are 'balanced against assets.' The various liabilities and receipts are regarded as growing in the course of time. This system, amongst other advantages, possesses that of allowing 'a true statement of the operations of the period' to be made. It is difficult, he adds, 'to say why government accounting cannot be carried on successfully on the basis of accruals,'[3] though in the

[1] In France, for each of the years 1883, 1884, 1885, the uncollected receipts were about 2½ per cent. and the unpaid expenditure 11 per cent. of the total figures. Stourm, 123–4.

[2] See Masé-Dari, *Bilancio*, 57–8.

[3] *Finance*, 206–7.

case of the United States inferior discipline and the absence of centralisation in the administration of accounts may be suggested as reasons.

The real explanation lies somewhat deeper. It is to be found in the character of ordinary governmental finance which deals solely with a running revenue account that can be fairly represented by payments and receipts. In the case of an industrial company, it is necessary to show not merely the incomings and outgoings, but the 'earnings and expenses,' for on this depends the assignment of income between the different classes of shareholders. No such difficulty exists in the case of the State. Its 'earnings' are only tax claims, and its liabilities are incurred for services and commodities actually used in the period. The trifling amount that runs from one period to the next may be neglected,[1] and thus the superior simplicity of the cash account is not counterbalanced by any serious want of accuracy.[2]

Consideration of the different methods suggests that a development of the Italian system, providing a true 'capital' account for state finance, might be usefully employed in addition to the ordinary budget statement. This is specially important wherever there is a large industrial domain. The finances of Russia and Prussia cannot be properly understood without such an account, which is also requisite for the proper interpretation of Indian and Australian finance. But this is supplemental, and need not even be annual; a triennial or quinquennial valuation would in practice be found sufficient.

§ 6. From the legislative methods of dealing with the financial condition we have now to pass to the regulations under which the outlay of public funds is authorised and

[1] The case given by Prof. Adams (*Finance*, 207), of interest for the three months ending July 31st, when the fiscal year ends on June 30th, illustrates this. The two months will run on for each year. If, *e.g.*, the year for 1901–2 gains at the end, it loses at the beginning.

[2] In respect to semi-sovereign States, *e.g.*, Egypt, the method of accruals might be applied with advantage in order to separate the amount available for improvements from that assigned for creditors

verified. The most admirable provisions respecting the preparation and vote of the budget will be useless unless there is adequate machinery to secure conformity to the determinations of the legislature. The mechanism by which the revenues are drawn from the contributors to the Treasury of the State has been already noticed;[1] it remains to see how the collected public income is applied to the proper objects. The supervision of issues in England originally belonged to the Exchequer, which kept a careful but rather clumsy system in operation. With the growth of expenditure and income its methods proved defective. The accounts were many years in arrears, and a great deal of the expenditure was misapplied. The final audit of accounts was in a still more backward condition, and large sums were held by the Exchequer officials, while the different spending departments had unapplied balances in their possession. The first reforms of this evil were prepared by Burke, and carried into effect by Pitt in 1785, when he created the Board of Audit.[2]

Fresh abuses could not fail to arise during the long war period, and these in turn led to the reforms by which the Exchequer as a substantive institution was abolished and a better system of accounts adopted.[3] Various committees of inquiry disclosed further weaknesses in the machinery of control and audit, particularly in the influence of Parliament over the testing of the accounts. The final reforms consisted in the appointment of the Committee of Public Accounts (1862), and in the combination of Control and Audit in 1866 by the appointment of a Comptroller and Auditor-General.[4]

The system in use at present affords valuable guarantees

[1] Bk. vi. ch. 2, §§ 5, 6.

[2] Cp. Burke's great speech on 'Economical Reform,' particularly *Works*, ii. 81 sq.

[3] Sir H. Parnell vigorously attacked the methods of control existing when he wrote (1830). *Financial Reform*, ch. 11.

[4] The occasional 'committees on finance' became the annual Committee of Accounts in 1862. The Act reorganising the control and audit department is 29 and 30 Vict. c. 39.

for the legal issue and due application of the revenue that the earning departments bring into the Treasury, *i.e.* the Bank of England, where it lies to the account of the Comptroller and Auditor-General. For every payment there must be the following steps: (1) a requisition by the Treasury to the Comptroller-General, having as its ground an Act of Parliament; (2) a grant of credit by the Comptroller-General, who is bound to satisfy himself as to its accordance with the terms of the law on the faith of which it is issued, and which lasts only for the current year; (3) a Treasury order to the Bank to transfer the specified sum from the Comptroller's account to that of the Paymaster-General for the particular service. There must therefore be the clearest legal sanction for both the object and amount of every grant. The Bank of England is the sole receptacle for the collected revenue, and the Comptroller-General's order the only key that unlocks its coffers.[1]

In France the modes of disbursement are affected by the existence of the subordinate local treasuries, from which payments are made, and whose heads profit by the public funds that they hold. The responsibility for grants rests on the particular department requiring them and on the Ministry of Finance; but though a number of distinguished financiers have laboured to made the system of control effectual,[2] it is as yet defective in the absence of any external preventive authority over issues.

The Italian system has here followed the English one by requiring an authorisation from the 'Court of Accounts' before any payments can be made from the Treasury;[3] and the Prussian 'Curators of the Treasury' discharge a like function in that country.

In the United States the issues are regulated by the

[1] The Bank of England by its management of the debt and its practical custody of the revenue is, in a sense, a government bank, but not a state one. Cp. Bk. ii. ch. 4, § 2.

[2] Mollien, Baron Louis, and Audriffe may be mentioned.

[3] So have also Belgium and Holland.

auditors and comptrollers in accordance with a series of Acts dating from 1789, the latest of which was passed in 1894. The original idea that the Treasury was to be the sole department concerned with outlay has been gradually modified. Disbursing officers have been found necessary, and the investigation of claims has required the establishment of a special court.[1]

§ 7. Distinct from the control over issue and quite as necessary is the audit of accounts. There is little advantage in preventing unauthorised payments to departments if they afterwards misapply the funds received for specific purposes. To guard against this danger another duty has been placed on the Comptroller- and Auditor-General, who in this second capacity is bound to discharge the duties of the Board of Audit whose place he has taken, just as it superseded the inefficient audit of the ancient Exchequer. The work consists of two distinct parts—viz. (1) the verification of the accounts in order to see that no improper expenditure in the ordinary sense has been incurred, and (2) the appropriation audit, which inquires into the application of the funds and its conformity with the directions of Parliament.

This latter check, first applied to the navy expenses in 1832, was extended to the army accounts in 1846, and became general in 1866.[2] The Auditor-General is bound within a limited period to report to Parliament on the results of his inquiry, noting any irregularities that he has discovered, and as a final barrier to misappropriation the Committee of Public Accounts goes over the expenditure again in a close and critical manner. Under such conditions no great departure from the line of expenditure marked out by the budget can escape notice, though petty errors and small illegal payments are not unknown. The

[1] For an admirably clear account of the U.S. system see Adams, *Finance*, 193–200. See also the articles on 'The Control of National Expenditures,' by E. I. Renick and N. H. Thompson. *Political Science Quarterly*, vi. 248–281, and vii. 468–482.

[2] Todd, *Parliamentary Government*, ii. 57 sq.

weakest points of the system are (1) the fact that the Auditor-General is only an administrative official, and (2) the absence of any sufficient sanction to support the rulings of the auditing bodies, who can only report to Parliament the outcome of their investigations and the errors that they have discovered.

The United States Congress had long preceded England in this line by appointing in 1814 a Committee on Public Expenditure, to which other committees for separate departments were from time to time added.[1] Owing to inefficient bookkeeping and undue extension of credits the detection of erroneous applications of funds was not easy, and a good deal of entirely illegal expenditure escaped notice. Absence of unity in the financial administration shows its effects even in this apparently mechanical part of the system, by complicating the forms of the public accounts.[2]

The control of the finances in France is assigned to an independent body, the *Cour des Comptes*, which examines the accounts judicially, and also reports to the legislature on any infractions of the law of the budget. The former power was bestowed on it by Napoleon I. at its creation in 1807; the latter was given in 1831. The two functions broadly correspond to the two duties of the Comptroller-and Auditor-General, but the French court differs in being a judicial body, not an administrative official, though its independence is perhaps less solidly guaranteed. When combined with the internal audits of the several ministries and the legislative control that the final law of the budget gives to the assembly, it would seem that the mechanism of the French system is hardly susceptible of much substantial improvement.[3]

Other Continental countries have followed the French

[1] According to Adams, 'The House of Representatives has not seen fit to continue its experiment with what perhaps may be termed a legislative auditing committee.' *Finance*, 200.

[2] Wilson, *Congressional Government*, 175; also Bolles, *Financial History* (1861–1885), 523 sq.

[3] Stourm, *Le Budget*, chs. 28 and 29.

model, but with certain useful modifications due to English example. The Prussian 'Court of Accounts' holds inquiries on the spot, and is not limited (as in France) to the examination of documents submitted to it. The position of its President nearly resembles that of the Auditor-General, and its procedure is often administrative. Several countries give their 'Courts of Account' a preventive control over issues of money and greater latitude in dealing with cases. Such variations do not at all affect the general truth that the conditions of a proper audit have been established in all civilised countries, and only require the existence of a sound constitutional sentiment in the legislature to make them effective.

§ 8. With the verification of the public accounts and the establishment of their conformity to the law concludes the cycle of processes relating to a financial period. In this and the preceding chapter we have shortly noted the working of the financial machine without entering into questions of constitutional law or administrative practice, and regarding simply its effect in securing the best application of revenue to expenditure. It but remains to again lay emphasis on the fact that good finance cannot be attained without intelligent care on the part of the citizens. The rules of budgetary legislation are serviceable in keeping administration within limits; but prudent expenditure, productive and equitable taxation, and due equilibrium between income and outlay will only be found where responsibility is enforced by the public opinion of an active and enlightened community.

CHAPTER IV

ADMINISTRATION AND CONTROL IN LOCAL FINANCE

§ 1. THE characteristic features of local finance have already been sufficiently described,[1] but, owing to the increased importance of municipal administration and the greater activity of the smaller governing bodies, it is desirable to consider briefly the financial mechanism most appropriate for their efficient working, as well as the way in which actually existing systems have been developed. In this connexion the chief distinguishing circumstance as regards local government is its subordinate position. The rules of the budget are, so to speak, set by the State to itself. Just as the sovereign can arbitrarily determine his expenditure, use compulsory power for the levy of any taxes that he desires, and decline to pay either the principal or interest of the wealth he has borrowed, so is he legally free in respect to the mechanism that he employs and the accounts that he renders. Necker's *Compte Rendu* was regarded as an act of grace on the part of the King, and, indeed, it is only the gradual recognition of society as a force behind, and superior to, the actual government that has supported the constitutional rules of modern States on the subject of financial procedure.

It is evident that the municipality or district is in a different position. Its powers are, legally, the result of a delegation, and it may be compelled by due process of law

[1] See *supra*, Bk. i. ch. 7 ; Bk. iii. ch. 6 ; Bk. v. ch. 8.

to account for its proceedings in regard to expenditure, levy of taxation, or borrowing. The preponderating weight of the economic element in local government also tends to assimilate its financial mechanism to that of an industrial company. The corporation of a city might almost be described as a 'Paving, Drainage, Water-supply, Lighting, Health, and Police-protection Co.' As a necessary consequence, there are certain general forms in which the finance of local bodies will, usually speaking, be moulded, and certain limitations will naturally be imposed by the central authority. It is this side of local finance that is just now in most urgent need of attention.

§ 2. In the course of historical development, we find the free cities of Italy and Greece brought under the centralising power of Rome, and, in particular, we notice the financial restraints imposed by imperial authority.[1] Expenditure and taxation were both rigidly controlled by the officials of the State. Feudalism presents a very different picture. The absence of a strong official body and the general disintegration of authority led to the comparative freedom of local governments from financial control. Such action as was taken by the King was occasional and spasmodic, so that the towns really developed a particular kind of quasi-private economy, and managed their finances as substantially independent corporations. Even the establishment of the centralised monarchies towards the close of the fifteenth century did not at once produce a decided change. It took a long time to build up an effective administrative organisation, able to deal thoroughly with local privileges.

In England the establishment of the Elizabethan Poor Law gave new power to the smallest local unit, the parish, which had the duty of maintaining highways, as also the support of the Church, placed on it by common law. But the only controlling force was the action of the Courts proceeding by indictment or by the issue of particular writs. The town corporations were similarly placed, and

[1] *Supra*, Bk. i. ch. 7, § 4, and Bury, *Student's Roman Empire*, 440-2.

thus the financial arrangements were allowed to fall into a condition of confusion and extreme irregularity. A first step in reform was the great Poor Law measure of 1834, which gave the Poor Law Commission control over Union finance. Other measures, *e.g.* the Public Health Act (1875), have introduced regulations for the limitation of local debt and the presentation of proper accounts. The latest steps are those made by the Local Government Acts for England (1894) and Ireland (1898).

The regulations of the *Ancien Régime* were replaced in France by the Napoleonic system, with its rigorous supervision of the Communes and Departments. Though somewhat mitigated by later legislation,[1] the French system is still one of administrative tutelage. Italy, Spain, and Portugal follow the same method which applies directly to financial administration.

Germany (and Prussia in particular) is somewhat differently placed. The older bureaucracy has yielded part of its power to the local bodies, and further development in this direction may be expected.

In the United States the treatment of local government on its financial side is necessarily varied, owing to the distinct types of local institutions,[2] and to the fact that each State has full power in dealing with its local governments. There is, however, a pronounced general tendency towards restricting the financial power of municipalities by legislative regulation, to be enforced on application by the courts. America, like England, has only the rudiments of an administrative law, and has therefore to trust to judicial remedies.

§ 3. The several problems of the national budget ought—so it would seem—to present themselves in respect to each local body, but it must be remembered that the work of these small units is much more administrative than legislative, or, more accurately speaking, that the principle of the separa-

[1] Goodnow, *Comparative Administrative Law*, i. 271.

[2] See Bryce, *American Commonwealth*, ch. 48.

tion of powers does not apply in local, as it does in central, government. Hence, the first step of the budget—the estimate of expenditure and receipts for the financial period will be made by a responsible subordinate official and placed before the members of the governing body. Such is the usual course in the Poor Law Unions of the United Kingdom and the smaller municipalities. When the duties are more considerable, and the funds handled of large amount, a special finance committee is formed, and the estimates of expenditure made by other committees consolidated by it, and also an equivalent amount of revenue provided by a duly calculated rate. In fact, the most developed local budget is, so far as its establishment is concerned, somewhat like the rather crude system of the United States.[1] The chief reason is, of course, the just-mentioned administrative character of local government, but it is also due to its more limited field of work and the overshadowing power of the State. A local body has only to deal with certain definite lines of expenditure, and must keep its taxation within limits both of form and amount. Another influence which prevents the full development of the local budget is the specialisation of the funds with which it deals. The State can insist on unity in its budget system, but the locality has to present different accounts for distinct branches of expenditure. Its highway rate may be different from its water rate, as a general improvement rate may be distinct from either. In England there is the further probability that separate bodies may administer different services. The Corporation, described above (§ 1), may have beside it a 'Poor-Relief Co.,' and a 'Free Education Co.,' in the shape of 'Guardians' and a 'School Board.' A true budget could be secured only by combining these several heads of expense with the parallel receipts.

Recent legislation has done much for the United Kingdom in the direction of greater simplicity and uniformity as well as in securing fuller publication of financial arrange-

[1] *Supra*, ch. 2, § 2, and Adams, *Finance*, 125–9.

ments. The general Borough rate for towns and the Poor-rate (very improperly named) for counties are the principal charges, and they both admit of definite statement and simple explanation. Thus it may be said that, when properly co-ordinated, local government can have its series of budgets, each arranged for the suitable body and prepared in correct form.

This result is attained in France by the regulating hand of the central government, and is being gradually accomplished in Great Britain. Specialisation of funds has to be retained in order to secure just distribution, but this need not hinder the establishment of a formal unity in the presentation of accounts.

The proper financial period is beyond doubt the same as that selected by the State. This has the immense advantage of permitting the combination of the national and local budgets for statistical and administrative purposes.[1] It also facilitates criticism of the course of local finance, and calls attention to any decided change that may have taken place.

§. 4. The voting of the budget, which is so important a matter in the national legislature, necessarily occupies a minor part in local finance. Assuming that expenditure has been properly incurred, provision must be made to meet it, and generally speaking, this has to be done from a prearranged fund. The local body that refuses to levy a requisite rate may be forced to do so by legal penalties, or be superseded by administrative action, while the political effects that follow from a refusal of the central budget are wholly absent. Thus this part of finance is apparently a piece of ordinary routine. It would nevertheless, be dangerous to press this conclusion too far. Wise criticism of the local finances is most effective as a check on future rash expenditure, or as a hindrance to undue borrow-

[1] British local finance has become much more intelligible since the financial year has been arranged.

ing. When a local body has some discretion as to objects of imposition the budget needs more careful inspection in order to secure the best selection of taxes, but in any case it is only through discussion of the accounts as a whole that the body of taxpayers can be brought to consider the financial position of the local government in which they are interested.

Similar considerations apply to the separation of the items and the assignment of the charges peculiar to the period. Though not so important as in national finance, they should not be neglected. More particularly is this the case with regard to the division between 'capital' and 'revenue.' It is so easy to place expenditure to the account of capital, while receipts of the same kind are treated as revenue, that vigilance in this respect, though unobtrusive, is most serviceable. This caution is more needed when a local government possesses large economic revenue.[1] Here the temptation to exaggerate the receipts and to limit allowances for depreciation and renewals of capital is so great, that the accounts demand the most vigilant scrutiny.[2] Perhaps the best safeguard would be the insistence on a separate capital account for each head of trading business, but even this could in practice be evaded by charging expenses to other heads.

§ 5. Whatever be the safeguards that enlightened local opinion may provide through its examination of finance, there remains the absolute necessity for control and audit by external authority. The most elementary step in this direction is that of making members of the local government liable for any illegal expenditure that they have sanctioned. This method of 'surcharge' applied by the Courts or by official auditors hinders the grossest mis-

[1] See Bk. ii. especially ch. 2, §§ 5, 6, 18.

[2] The movement in England towards what is called 'municipal trading' has greatly increased this danger. See Row-Fogo, 'The Statistics of Municipal Trading,' *Economic Journal*, xi. 12–22.

application of funds. It is analogous to proceedings against company directors or agents for fraud on shareholders or principals.

This check is, however, much increased in efficiency when special provisions are made as to the amount of funds to be raised and their application. Thus rules directing that the annual rate shall not exceed a certain amount in the pound, that borrowing shall not exceed so many years' valuation of the area charged, that expenditure for a given purpose shall not exceed a specified amount, have the effect of tightening the control of the Court or auditor who has to deal with the matter. In this respect there has been a decided improvement in the last twenty-five years. The rules prescribing and limiting local expenditure have been improved in form and substance, while the machinery of audit has been strengthened. Though defects undoubtedly still exist,[1] they are being gradually removed.

§ 6. There remains, however, the great difficulty of dealing with discretionary outlay. So far as the tasks of local government are assigned, the administrators may be regarded as 'harnessed'—to employ Gneist's conception—for the public work. It is when the element of choice comes in that the problem begins to be serious. If local government is to be a reality there must be opportunity given for mistakes, and these mistakes will injuriously affect the taxpayers concerned. If a town authority takes up the waterworks, tramways, electric lighting, and telephone service of its district; if it, in addition, provides parks, libraries, and baths, and, further, supplies public amusements on a liberal scale, the financial results may not always prove satisfactory, and it then becomes a practical question to determine whether those who actively dissented from the policy in question should be sufferers in consequence of its failure. Mere rules as to audit are quite ineffective in such a case. The

[1] The audit of the accounts of English boroughs is unsatisfactory as it is conducted by elected auditors. See *Report* on 'Municipal Trading' [305, 1900], 137–141. The Irish system is, in this respect, better.

only adequate safeguard is a peremptory limitation of the sphere of local activity, coupled with such regulations as will provide against the more extreme forms of mismanagement. The fact that the loss in such a case as that suggested would fall on a few is, in a sense, an aggravation of the evil, since it is, in Bentham's language, 'concentrated.' There is here accordingly need for a special form of control, which may perhaps be called 'political,' as it is to be used at its discretion by the central power, which would, after inquiry, readjust the burdens incurred.

Finally, for local as for central finance it is essential to dwell on the need for intelligence and vigilant activity on the part of those concerned. The ratepayer must watch the proceedings of those who direct his affairs, and if he is wanting in this respect, he must blame himself, in part at least, for any unfortunate result. It is only by pressure diligently used by the better citizens that the finances of town and country districts can be kept up to a high standard.

INDEX

INDEX

A

ABILITY as measure of taxation, 300–2
Acts, taxes on, 277, 356, 580–593
Adams, H. C., 36, 624, 747 *n.*, 751 *n.*; accruals, 755–6; deficit, 46 *n.*; expenditure, theory of, 147–8; income tax, English, 481 *n.*, 677 *n.*; incidence, 361; inheritance taxes, 606 *n.*; 'limited option,' borrowing, 687; on local debt of U. S., 713; on sinking fund, 703 *n*; universality of public borrowing, 625 *n.*
Administrative supervision, 82–85
Aides, 340, 523
Alcavala, 345, 507
Alcohol, monopoly of, 536, 539; taxation of, 506, 518–20, 527–8, 538
Alessio, G., 34
America, *see* "United States."
Ancien Régime, 729; farming taxes in, 523; indirect taxation under, 522–3
Apportioned taxes, 273, 428, 743
Army, national, cost of, 65–6
Assessed taxes, 308 *n.*, 500
Assessment, triple, 479, 500
Assessments, special, 164, 166–7, 402–4
Audit of accounts, 759–60; appropriation, 759
Auditor-General, *see* Comptroller-General.
Audriffret, de, 28, 758 *n.*
Augustus: inheritance tax of, 591
Austin, J., 42, 165
Australasian Colonies: financial system, 129 *n.*; inheritance taxes, 605; methods of borrowing, 691; public debt of, 657; public lands in, 175; railways, 221–2
Austria: public debt, 656; forests, 188; house tax, 447; income tax, 487; internal taxation, 535; lands, 172; land tax, 437; newspaper duty, 579; *octrois*, 535, 545–6; railways, 219; trade tax, 461
Austria-Hungary: financial system of, 128, 328, 329 *n.*; tariff, 568. *See also* 'Austria' and 'Hungary.'
Avebury, Lord: 370, 371 *n.*, 388 *n.*, 468 *n.*, 696 *n.*

B

BADEN: capital, tax on, 454; debt, 652; industry, tax on, 461; railways, 219
Baden-Powell, B. H., 174 *n.*
Bagehot, W., 658, 748 *n.*
Balfour, A. J., 353 *n.*
Banks, state, 233–4
Bardi, the, 620
Bastiat, 186, 205; on taxation, 283
Bavaria: army, 122 *n.*; capital, tax on, 454; debt, 652; industry, tax on, 461; land, 172; —, tax on, 436; post office, 206; railways, 219
Baxter, Dudley, 35
Beccaria, 80
Beer duty, 515, 517–9, 525, 533
Belgium: expenditure, increase of, 140; land tax, 435; *octrois*, abolition of, 406, 546; railways, 220
Bengal; land settlement, 173; opium regulations, 197
Bentham, 51, 77, 80, 318, 416, 581
Bergregal, 192
Berlin: beer duty, 545; gasworks, 200; water supply, 199, 201 *n*

Bern, 118; postal convention, 208 *n.*; state treasure, 613
Blackstone, 154 *n.*, 161, 270 *n.*
Blunden, G. H., 35, 321 *n.*, 407 *n.*, 440 *n.*, 482 *n.*, 677 *n.*
Bluntschli, 52
Bodin, J., 19–20, 155, 300
Boisguillebert, 22, 340
Bolla, 507
Bolles, A., quoted, 653; on cost of U.S. civil war, 131 *n.*
Booth, C., 90 *n.*
Brazil: export duty in, 569; railways, 221
Broggia, 33
Budget, the, 5, 730; definition, 734; preparation, 735–41; vote, 746–52
Budgets, special, 739
Burke, E., 757
Business, taxes on, *see* "*Gewerbesteuer*" and "*Patente.*"
Buxton, S., 35

C

Cadastre, 429–31
Cairnes, J. E., 64, 668 *n.*
Cambon, 644
Cameralwissenschaft, 8, 20, 28, 101
Canada, Dominion of: land revenue, 175; railways, 221
Canals, 212–13
Canard, N. F., 14 *n.*, 28, 369, 371 *n.*, 420, 441, 674
Cannan, E., 35, 335 *n.*, 336 *n.*; 'incidence,' 361; postal revenue, 210 *n.*; rate, meaning of, 269 *n.*
Capital, taxes on, 272, 289–90, 311–12, 452–5, 591–2. *See also* "House taxes."
Capitation tax, 465–8
Carey, H. C., 186
Carlyle, T., 613
Carnegie, A., 96 *n.*
Carolingian Empire, 727, 742
Cato, 498 *n.*
Centralised monarchies, 19
Centimes additionels, 406, 441, 446, 459
Chalmers, 665–6, 668, 673
Chapman, S. J., 35
Charlemagne, 181
Charles I., 203, 515, 685
Charles II., 515, 521
Childers, H. C., attempted conversion by, 638–9
Chile: export duty, 569; railways, 221
Churches, established, 98–100
Cincinnati, assessment of property, 474 *n*
City finances, 19;—State, 54, 113, 726
Clamageran, J. J., 28
Cobden, R., on government factory accounts, 195–6 *n.*
Cohn, G., 32, 132, 147, 223, 227, 276, 292, 314, 319, 326, 413 *n.*
Colbert, 21, 26, 49, 412, 522, 563, 643, 736
Commune, 189–90, 250, 391, 406, 409, 713, 720, 764
Comptroller-General: his functions, 757–60
Comte, A., 51
Condorcet, 662
Conigliani, C. A., 33–4
Conjuncturgewinn, 325, 582
Conrad, 32
Constituent Assembly, 237, 523, 731
octrois abolished by, 523, 543
Constitutional expenditure, 106–7
Consumption taxes, direct, 497–503
Conversion of debt, 705–7
Copyholds: legislation, 237
Corporation tax, 332, 333 *n.*, 454, 461–2, 475 *n.*
Corvée, 264
Cossa, L., 6 *n.*, 33, 265–6
Cour des Comptes, 760–1
Cournot, 28, 375 *n.*
Culturstaat, 52
Customs duties, 551–73

D

Daniels, W. M., 2 *n.*, 36
Darwin, C., on Fuegians, 53
Davenant, 22
Death duties, *see* "Successions."
Debt, local, *see* "Local Debt"; —, public, amount of, 626–7; conversion of, 705–7; development of, 621–6; evils of, 624–5; floating, 694–5; forms of, 685–91; history of, 629–57; inconvertible paper, 695–7; pressure of, 680–4; redemption of, 698–705; theory of, 658–79
Decker, Sir M., advocates single tax, 22, 340
Degressive taxation, 316–17
Devas, C. S., 248 *n.*, 309 *n.*, 421
Dicey, A. V., 161
Dietzel, C.: his debt theory, 134 *n.*, 666
Dilke, Sir C., 67 *n.*, 605 *n.*
Dîme Royale, *see* 'Vauban.'

Diocletian, 427
Direct taxation, compared with indirect, 349 *sq.*; various meanings of, 271–2, 347–9
Dog tax, 501
Domain: forests, 186–90; industrial, 191–231; lands, 169–86; meanings of term, 249; unproductive, 246–8
Domesday Book, 429
Double taxation, 332–4
Dowell, S., 35
Du Pont, 24, 49, 291
Dunoyer, 51

E

Economy, state: characteristic features of, 42–7
Edgeworth, F. Y., 35, 449 *n.*; incidence, 360 *n.*; indirect taxation, 353 *n.*; least sacrifice, principle of, 302
Education, 92–8; technical, 96–7
Edward III., 620
Edward IV., 203, 620
Eheberg, 32
Ehrenberg, R., 621 *n.*, 643 *n.*
Ely, R. T., 37; definition of tax, 268; property tax, 474; railway taxation, 578 *n.*; state income taxes, 475 *n.*
Emerson, 625 *n.*
Emphyteusis, 167, 183
England, Bank of, 744, 758,
England: advertisement duty, 578–9; audit, 756–8; budget, 735, 737, 747, 748, 753; death duties, 597–602; debt, national, history of, 629–42; —, local, 713; direct consumption taxes, 499–501; excise, 514–22; expenditure, increased, 138–40; financial control, 729–31, 756–8; house taxes, 444–5; income tax, 478, 479–83; land tax, 238; land, taxation of, 431–432; lands, Crown, 170–1; municipal industries, 198–202, 225; poll-tax, 466; post office, 203–4, 207–8; railway passenger tax, 576–7; savings bank, 234; stamp duties, 584–5
Ergänzungssteuer, 476
Estate duty, Lord Goschen's, 597 *n.*, 598; new, 599
Exchequer, the, 727, 757
Excise, the, 504; development of, 514–22
Expenditure, public, 4; extraordinary, 130 *sq.*; increase of, 138–40; limits of, 136–7; productive and unproductive, 134–5
Export duties, 552–3; decline of, 553; examples, 569; incidence, 571–2

F

Falck, 32, 365
Farming taxes, 552–3, 742–3
Farrer, Lord, 75, 407–8
Fawcett, H.: Indian budget, 230; incidence of rates, 452 *n.*
Federal State, 117–18, 128, 329, 409
Fee principle, 212
Fees, 155–7; administrative, 242–3; educational, 93, 244; judicial, 76–7, 241–2; position of, in finance, 159–61, 165–6, 240
Feudalism, 18, 54, 159 *n.*, 726, 728; based on contract, 298
Finance, meaning of term, 1 *n.*
Finance Act, 1894, 334 *n.*, 492, 598–601
Finance, public, and economics, 7–9 and history, 10–11; and statistics 11; method, 11–14; scope, 3–7
Flora, F., 33
Florence: financial theories in, 19
Forests, state, 186–9
Foville, de, 681 *n*
Fowler, Sir H., on local taxation, 431, 445 *n.*
France: acts, taxes on, 585–7; budget, 735, 737, 749, 754–5; canals, 212; capitation, 466; commodities, internal taxes on, 501–2, 522–8; communications, taxes on, 577; customs duties, 563–6; debt, history, 643–9; —, present position, 649–50; expenditure, increase of, 140; financial studies in, 27–8; forests, 171; house tax, 445–6; income tax, proposed, 489; lands, public, 171; land tax, 432–4; law taxes, 581; *octrois*, 543–4; *Patente*, 457–60, 463; post office, 204–5; railway policy, 215–7; succession duties, 602–4; tobacco monopoly, 197, 525
Francis I., 620
Frederick the Great, 62, 613
Frederick William I., 613
Freycinet, de, 105, 648

G

Gaius, 169 *n.*
Gallatin, A., 703, 736
Garelli, A., 33
Garnier, J., 28, 306, 416

Gaudin, 352, 645
Geffcken, quoted, 66
Genoa, Bank of, 621
George III., 559
Georgia: property tax, 473
Germany: commodities, internal taxes on, 531–4; customs, 567–8; debt, 651–2; financial studies in, 28–33
Gewerbesteuer, 460–1
Gide, C., quoted, 194 *n.*
Giffen, Sir R.. 69, 295, 320 *n.*, 370, 394 *n.*, 682 *n.*, 698 *n.*
Girardin, E. de, 342
Gladstone, W. E., 36, 46 *n.*, 331 *n.*, 517, 584, 594, 597, 635, 637; condemnation of borrowing, 675 *n.*; income tax, character of, 481; expenditure, increase of, 138–9; succession duty, 598
Gneist, 79, 306, 768
Goschen, Lord, 91, 236, 243, 440 *n.*, 444, 597 *n.*, 601 *n.*, 752 *n*; debt conversion, 639; debt treatment, 637; localisation of income tax, 395; local taxation, chaos in, 116
Graubünden: income tax, 487–8; property tax, 471–2
Graziani, 33
Greece: ancient, 17; land tax in, 435–6
Grenville, 680
Grist tax, 529
Guyot, Y., 342

H

Hadly, A., on certainty in taxation, 420 *n.*
Hall, H., 35
Hallam, H., 620
Hamilton, A., 328, 329 *n.*, 369 *n.*, 536, 652, 703, 736
Hamilton, Sir E. W., 263 *n.*, 370, 371 *n.*, 404 *n.*, 408 *n.*
Hamilton, R., 27 *n.*, 131 *n.*, 631, 636, 664, 692, 701, 703, 705
Hancock, W. N., 342 *n.*
Harcourt, Sir W., 752 *n.*
Held, A., 366, 416
Henri IV., 613
Henry VIII., 171, 203, 613
Hermann, B. W. F., 292, 306, 318
Hesse: budget, 753; railways, 218
Hewins, W. A. S., 412 *n.*
Hill, R., 204, 207
Historical school, 30, 307
Hock, Von, 29; limit of expenditure, 136; classification of taxes, 277; rules of taxation, 416
Hoffmann, 29, 276
Holland, B., 344 *n.*
Holland: property tax, 476–7; railways, 220, 225; stamp duties introduced in, 579
Hollander, J. H., 37
Hops, duty on, 519
House taxes, 397, 443–52; incidence of, 400–1, 449, 52
Howard, 80
Hume, D., 23, 98, 102; profits, taxation of, 284; public debts, effect of, 633–4
Hungary: commodities, internal taxes on, 535; debt, 656; house tax, 447; lands, 172; land tax, 437; *octrois*, 545; railways, 220; zone tariff, 220 *n.*
Huskisson, 345, 517

I

Import duties, 553; increase of 569–70; incidence, 572
Impôt de quotité, 273 *n.*
Impôt de répartition, 273 *n.*
Impôt foncier, 237, 272, 273, 276, 433, 459
Incidence of taxation, 13, 360–88, 439–42, 449–52, 454–5, 463–4, 468, 493–4, 548–50, 570–3, 577–8, 588–9, 607–8
Income, taxes on, 477–94
India: export duties, 569; forests, 188; industry, 196; land systems, 173–4, 430 *n.*; railways, 222; revenue system, 11, 256–7, 537–8
Inheritance, taxes on, *see* "Successions."
Ireland: income tax, 438, 480; intermediate education, 94 *n.*; land, competition for, 184; local debt, 713; spirit duties, 519; taxation of, 295, 330–2, 432; tea duty, 353 *n.*; tobacco, 521 *n.*
Italy: acts, taxes on, 587; custom duties, 566; debt, public, 650–1; —, local, 713; expenditure, increase of, 140; finance, study of, 33–4; income tax, 483–5; internal taxes, 529–31; land tax, 434–5; *octrois*, 394, 530, 544–5; railways, 220; succession duties, 604

J

Jacob, 666
James II., 203
Java, culture system in, 233

Jevons, W. S., 35, 224, 226, 307, 382, 709
Justi, 21, 136, 155 *n.*, 166, 177, 318, 412
Justice, cost of, 76-9

K

Kaizl, 32
Kinley, D., 37
Klock, 20 *n.*, 155

L

Lacava, P., 34
Laissez-faire, 49–51, 84, 105
Land, nationalisation of, 176-7, 185; —, public, 169–86, 189–90; —, taxation of, 425–42
Lassalle, F., 507 *n.*
Laveleye, E. de, quoted, 435 *n.*
Law, J., 661
Law, *see* "Justice."
Lecky, W. E. H., 312 *n*
Legacy duty, 597
Leroy-Beaulieu, P., 28, 283; inconvertible paper, 696; increased expenditure, 136, 141; local taxation, 407; progressive taxes, 304, 309 *n.*, 314; scope of finance, 5–6
Leslie, Cliffe, 35, 64 *n.*, 66, 348 *n.*, 354, 366, 367, 668 *n.*
Levasseur, 306
Levi, L., 35
Local debt, 712–22; increase of, 712–4; reproductive, 714–5; — expenditure, heads of, 119–25; — finance, 15, 115–6, 119–27, 166, 198-203, 225, 250–3, 389–410, 502–3, 542–5, 712–22, 762 *sq.*; — government, control of central over, 126–7, 408–10, 721–2, 762–9; sphere of, 110–19, 125–6, 189–90; — taxation, 389–408, 542–5
Locke, J., 22, 341, 362–3, 368
Lodge, H. C., 329 *n.*
Lotteries, state, 234–5
Louis XI., 204; — XIV., 644
Lowe, R., 754 *n.*

M

Macaulay, T. B., 13, 629, 663, 708
Macchiavelli, 19
McCulloch, J. R., 27, 34, 306, 336; profits, tax on, 284–6; taxation, diversity of, 525; tithes, incidence of, 379, 439 *n.*
McNeil-Caird, 123
Madras, land settlement in, 430 *n.*
Maine, H. S., 34, 159 *n.*
Malchus, 666
Malt tax, 515, 518–19
Marshall, A., 289 *n.*, 294 *n.*, 318 *n.*, 325 *n.*, 382 *n.*, 592 *n.*, 720 *n*
Martello, T., 33
Masè-Dari, 33, 305 *n.*, 726 *n.*, 747 *n*
Matricular-beiträge, 256 *n.*
Mazarin, 43, 685
Mazzola, U., 33
Mechanical revenue, 249–50
Menger, 307
Menier, 342
Mercantile system, 20, 553, 554
Mercier de la Rivière, 291, 347
Meyer, R., 32
Mill, J. S., 285, 306, 352, 368, 708; government, functions of, 47, 50–1, 56, 84; income tax, 462; loans, Chalmers's theory of, 665, 667–8; net produce, 292, 294; savings, exemption of, 493; subsistence, minimum of, 318, 320 *n.*; taxation of capital, 289; —, direct and indirect, 271; —, equality of, 301; — of ground and building rents, 449; — of property transfers, 588; —, Smith's maxims of, 413 *n.*, 414; taxes, classification of, 274; incidence of, 366; — on profits, 285; — progressive inheritance, 596 *n.*; wealth, distribution of, 296
Miller, A. C., 692 *n.*
Mines, 191–4
Mirabeau, H. G., 267
Mirabeau, V., 24, 306, 341
Mobilier, 445, 457
Mollien, 645, 758 *n.*
Money economy, 237
Montesquieu, 22, 64; armaments, 63; public debts, 662–3; taxation, definition of, 266; —, progressive, 305
Monts de Piété, 235–6
More, Sir T., 19
Moulton, F., 35
Municipal trading, 197 *n.*, 200 *n.*, 767 *n.*
Murray, Sir G. H., 371 *n.*, 401 *n.*, 406 *n.*

N

Napoleon I., 482, 634, 645, 647, 760
Navy, cost of 67–8
Nebenius, 29, 666
Netherlands, the, *see* "Holland.
Neumann, 32
Newcomb, S., 88

Newman, F. W., 308 *n.*
New York: assessment of property, 474; inheritance tax, 605
Nicholson, J. S., 35, 366, 371 *n.*, 381 *n.*, 414, 682 *n.*; expenditure, theory of, 148–9; progressive taxation, 309 *n.*, 310 *n.*, 312 *n.*, 313 *n.*
Noble, J., 35
Northcote, Sir S., 637
Norway: forests, 188

O

Octrois, 542–7; defects of, 394
Ohio: assessment of property, 474 *n.*; inheritance tax, 605; land tax, 427 *n.*; property tax, 473
O'Meara, 35, 407 *n.*
Opium, monopoly of, 197
Organic revenue, 249

P

PALGRAVE, R. H. I., 35; amount of national debts, 626
Parieu, E. de, 28, 265, 276, 279, 306, 314
Paris: debt, 713; gasworks, 200; *octrois*, 544; water supply, 199
Parnell, H., 27, 44 *n.*, 196 *n.*, 480, 757 *n.*
Patente, Droit de, 457–9, 460, 462, 463
Peel, Sir R., 43, 46 *n.*, 636, 754 *n.*; re-establishes income tax, 480, 482
Penal system, 80–1
Personal taxes, 272
Peruzzi, the, 620
Peto, S. M., 35
Petty, Sir W., 22
Physiocrats, 23–4, 101, 177; education, 92 *n.*; *impôt unique*, 341; indirect taxation, hostility to, 507 *n.*; *produit net*, 291; taxation, incidence of, 363–4, 380
Piernas Hurtado, J., 34
Pitt, W., 27 *n.*, 516, 559, 597, 757; assessed taxes, 500; debt, treatment of, 633–4, 692; sinking fund, 633, 702–3
Plehn, C., 2 *n.*, 36, 164 *n.*, 165 *n.*, 560 *n.*, 725 *n.*; classification of revenue, 167–8; expenditure, theory of, 147
Police, 79–80; meaning of, 79 *n.*
Political economy, 7–8
Political science, 1
Polizeistaat, 52
Poll tax, *see* "Capitation."
Poor relief, 85–90; a local function, 123
Portugal: *aforamento*, 183 *n*; land tax, 435
Post Office, 203–10, 575–6
Price, R., 701–2
Probate duty, 597
Progressive taxation, 305 *sq.*; experience of, 315–16; objections to, 308–13
Property taxes, 469–77
Proudhon, definition of taxation by, 266; progressive taxation, 313 *n.*
Prussia: army system, 64, 69; business tax, 460; class tax, 466; debt, 651; economic revenue, 255–6; expenditure, 140; house tax, 447; income tax, 315, 485–7; lands, 172; land tax, 436; local government, 119; lottery, 235; mines, 192, 193; post office, 205–6; property tax, 476; railways, 218–9, 227, 228, 232; succession duties, 604; treasure, state, 613; waterways, 213 *n.*
Pym, introduces excise, 515

Q

QUESNAY, F., 24, 49, 341, 363 *n.*, 384 *n.*; his maxims, 23, 136, 291

R

RAILWAYS, state, 213–28; taxation of, 576–8
Rated tax, 273
Rau, K. H., 8, 29, 314, 666; fees, originates distinction of, 155–7, 166; taxes, his classification of, 276
Real tax, 272
Rechtsstaat, 52
Revenue, taxation of, 288 *sq.* 591–2; public, forms of, 153–68
Ricardo, D., 27, 416; capital, taxation of, 288–9, 592; debt, payment of, by general contribution, 707–8; distribution, theory of, 378; expenditure, 146; house tax, incidence of, 449: national bank, 234 *n.*; necessaries, taxes on, 280, 386; profits, incidence of tax on, 380, 382; sinking fund, criticism of, 636, 703; taxation, incidence of, 365–6; his theory criticised, 366–8; — preferable to borrowing, 664–5; taxes, classification of, 274; tithe, incidence of, 379, 409; wages, taxes on, 292, 385
Ricca Salerno, 33
Richard II., 620
Robinson, 520
Rogers, J. E. T., 33; crown estate, 171; Adam Smith's maxims of taxation, 413 *n*

Roman Empire, 17–18 ; farming taxes in, 523, 743 ; land tax, 427–9 ; local administration, 113–4
Rome, salt mines, 191–2
Roscher, W., 29, 32, 43 ; expenditure, kinds of, 47;—, increase of, 140; communistic tendency in, 142 ; *regalia*, 239 ; tax, definition of, 265
Rosebery, Lord, quoted, 692
Rosewater, V., 37, 166
Ross, E. A., 37
Rousseau, J. J., 306
Row-Fogo, J., 407 *n.*, 408 *n.*
Russia : capitation tax, 467 ; debt, 656–7 ; lands, public, 172–3 ; railways, 220–1 ; commodities, taxation of, 535–6.

S

SALT, 191, 193 ; tax, 515–7, 522–4, 526, 529, 532, 537–8
Sargent, L. W., 35
Savings banks, 234
Sax, E., 32 ; progressive taxation, 307, 314 *n.* ; *regalia*, 158 *n.*
Saxony : debt, 652 ; income tax, 461, 467, 485, 487 ; lands, public, 172 ; railways, 219
Say, J. B., 27, 33 ; his golden maxim, 146 ; progressive taxation, 306
Say, Léon, 28, 439 *n.*, 687 *n.* ; income tax, 489 ; *octrois*, reform of, 547 ; progressive taxation, 304, 309.
Sayer, B., 27, 480
Schäffle, A. E., 30, 32 ; *octrois*, 546 *n.*
Schanz, G., 32, 593 *n.*, 605
Scharnhorst, 63
Schmidt, 32, 318
Schmöller, 30, 32
Schönberg, 32
Scotland : debt, local, 713 ; land, taxation of, 432 ; spirit duties, 286, 519–20
Seignorage, 243
Seligman, E. R. A., 36–7 ; 270 *n.*, 273 *n.*, 360 *n.*, 376 *n.* ; his classification of public revenues criticised, 163–7 ; house tax, incidence of, 449*n.*, 451 *n.* ; inheritance tax, nature of, 594 *n.* ; local taxes in U.S., 116 ; progressive taxation, 304 *n.*, 309 *n.*, 312 *n.*, 313 *n.*
Senior, N. W. : tithe, incidence of, 379
Sidgwick, H. : consumers' capital, 290 ; expenditure, adequate, 43 ; indirect taxation, 353 *n.*, ; inheritance taxes, 594 *n.* ; *laissez-faire*, exceptions to, 51, 84
Sinclair, Sir J., 27 *n.*, 664
Sinking fund, the, 631, 633, 635, 636, 654, 701–4
Sismondi, S. de : maxims of taxation, 415–6 ; minimum of subsistence, exemption of, 318.
Smith, Adam, 4, 6, 7, 20, 24–6, 29, 33, 82, 86, 101, 106, 161, 232, 290, 368, 387, 515, 542, 666 ; alcavala, 345 ; armies, development of, 61–2 ; his theory criticised, 62–3 ; Bohemia, survey of, 430 *n.* ; churches, established, 98–9 ; canals, 211 ; commodities, taxes on, 352 ; debts, public, evil of, 663–4 ; defence, cost of, 58 ; education, 92–4 ; expenditure, productive, 134 ; government, functions of, 49–50, 52, 56 ; ground rents, taxation of, 325, 449 ; house tax, 444, 448 ; import duties, function of, 554 ; income tax, 465 *n.* ; inheritance duties, incidence of, 607 ; interest, tax on, 380–1 ; inventions, premiums for, 104 ; justice, 74, 76 ; leases, register of, 428 ; pawnshop, public, 235 ; post office, 203 ; roads, 211 ; revenue, public, classification of, 155 ; Spain, cause of decline of, 345 ; state lands, 177–9 ; treasures, 613 ; taxation, incidence of, 364–5, 385, 449, 571, 588, 607 ; maxims of, 287 *n.*, 413–5 ; source of, 278, 288, 292 ; taxes, classification of, 273–4 ; transfer of property, incidence of tax on, 588 ; transit duty, incidence of, 571 ; wages, tax on, 385
Socialism, 231 ; state, 247
Sonnenfels, 21, 166, 318
Sorel, A., 22
Spain : alcavala, 345, 507 ; income tax, 485 ; land tax, 435
Spencer, H., 41 *n.*, 208
Spirit duties, *see* "Alcohol, taxation of."
Stanhope, 631
State functions, development of, 53–5
Statistics, use of, in finance, 11
Stein, L., 30–1, 32 ; domain, 249 ; taxes, reproductive, 369–70
Stewart, Sir J., 23
Stourm, 10 *n.*, 28, 732
Succession duty, 597–8 ; taxes on, 590–608
Sugar tax, 513–4, 526–7, 532–3, 540, 562
Sully, 412, 613, 643, 736
Switzerland : alcohol monopoly, 539 *n.* ; army expenditure, 122 *n.* ; forests placed under federal government, 190 ; income taxes, 487–8 ; inheritance taxes, 604–5 ; property taxes, 471–2

T

TACITUS, 362 *n.*
Taille, 428, 432, 469
Tax, definitions of, 262–69
Taxation, canons of, 411–21; distribution of, 296–337; forms of, 338–359; incidence of, *see* "Incidence."
Taxes, classification of, 269–80
Tea duty, 562
Theodosian code, 17 *n.*
Thiers, 369
Thurn and Taxis, 205
Tobacco monopoly, 197, 513, 522, 529; — tax, 497 *n.*, 521, 533–4, 538–9
Transit duties, 552, 554, 563, 569; incidence of, 571
Treasures, state, 612–18
Turgot, 6 *n.*, 24, 49, 101, 644; education, 93 *n.*; *impôt unique*, 341 *n.*; interest, 291–2; *octrois*, 341; profits, tax on, 380; wages, subsistence, 291 *n.*; tax on, 389

U

UMPFENBACH, 32, 140
Unearned increment, 179; taxation of, 324–7
United States: assessments, special, 402–4; audit, 760; budget, 747, 751; commodities, internal taxes on, 536–7; control, financial, 731, 735, customs, 568; debt, 652–6; —, local, 713–4; direct consumption taxes, 502; finance, study of, 36–7; income tax, 488; land, taxation of, 437; lands, public, 175; poll taxes, 467; property taxes, 473–5; treasury, 418 *n.*, 758–9
Universities, 94–6

V

VANDERLINT, 22; land, single tax on, 341, 363
Vauban, 12; *dîme royale*, 340–341; taxation, generality of, 303; maxims of, 412
Venice, loans of, 621
Verri, 412
Vignes, 28
Villèle, 736
Viti de Marco, 33
Vocke, 32
Voltaire, 662
Voluntary service: educational, 97–8; judicial, 79; military, 67
Vuitry, 28

W

WAGES, tax on, 367, 468; incidence of tax on, 384–6
Wagner, A., 29, 32, 287, 414; taxation, definition of, 268 *n.*; politico-social view of, 268 n., 335; rules of, 416, 417 *n.*; taxes, classification of, 276; war, advantages of, 70
Walker, F. 37
Walker, Gen. F. A., Adam Smith's maxims, 413 *n.*, 415
Walpole, 630; customs, treatment of, 549; excise scheme, 507, 516, 517; sinking fund, 631
Walras, L., 307
Warfare, cost of, 69–71; preparation for, 59–69
Wehrsteuer, 467
Wells, D. A., 36, 37; internal taxation in U.S., 536; property tax, 474; spirit duties, 539
West, M., 37, 590 *n.*, 592 *n.*
Wicksell, K., 34
Weiser, 307
Wilson, A. J., 35
Wilson, J., 569 *n.*, 571 *n.*
Wine duties, 522, 527–8, 558, 562
Würtemberg: debt, 652; forests, 172; industry tax, 469; railways, 219

X

XENOPHON, 17

Y

YOUNG, A., high rents, effect of 286 *n.*; on multiple taxation, 344–5

Z

Zöllverein, 532, 567
Zone tariff in Hungary, 220 *n.*
Zorli, 33
Zurich: income tax, 316–7, 487; property tax, 471

THE END

PRINTED IN GREAT BRITAIN BY R. CLAY AND SONS, LTD.,
BRUNSWICK ST., STAMFORD ST., S.E., AND BUNGAY, SUFFOLK

UNIVERSITY OF YORK LIBRARY
Heslington, York

Date of Return	Date of Return	Date of Return

C005 5207 00 05

NORTH
ROOM 1